

**Policy, Planning, and Research**

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**Public Sector Management  
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**Country Economics Department  
The World Bank  
October 1988  
WPS 118**

# **Contract Plans and Public Enterprise Performance**

**John Nellis**

**Contract plans help clarify goals, increase managerial autonomy, and open a dialogue between management and government — but their benefits have been oversold.**

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Roughly 100 public enterprises in developing countries (50 of them with Bank support) are using contract plans — negotiated performance agreements between the government/owner and the enterprises' managers or directors.

Contract plans have not improved the financial performance of public enterprises dramatically. The process is probably more important than the product.

They do produce clearer goals, open a dialogue between management and the state, and offer such benefits as better accounting, auditing, and management information systems, including physical and financial performance indicators and performance targets.

The problem is, they have been oversold. They are not the mechanism of choice for healing a sick company. They work best with firms that operate commercially and already have decent management and sound financial and reporting procedures.

In supporting contract plans, the Bank should keep ambitions modest and emphasize the clarification of goals, increased managerial autonomy, and open negotiating between management and government. Contract plans should not be a condition of Bank adjustment operations — at least not until the process has been tested and shown positive results in the country.

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**CONTRACT PLANS:  
AN ASSESSMENT OF THEIR UTILITY AS PERFORMANCE IMPROVEMENT  
MECHANISMS IN PUBLIC ENTERPRISES**

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**CONTRACT-PLANS:  
THEIR UTILITY AS PERFORMANCE IMPROVEMENT  
MECHANISMS IN PUBLIC ENTERPRISES**

**Executive Summary**

**I. Introduction**

1. Contract-plans are negotiated performance agreements between governments, acting as owners of a public enterprise, and the managers or directors of the enterprise itself. In a contract-plan (henceforth CP) the intentions, obligations and responsibilities of the two parties are freely negotiated and then clearly set out. This appears simple; but the fact is that ambiguity of goals and conflicting objectives have long been identified as major obstacles to the effective and efficient performance of public enterprises. CPs define the enterprise's objectives, and state what resources and latitude will be provided, by government, to enterprise management so that it may accomplish the specified goals. Many CPs set out the physical and financial indicators which will measure enterprise performance. Many establish the principle that government will compensate the enterprise for costs incurred in fulfilling non-commercial objectives, and specify the way in which the compensation will be made. In theory, the agreement concluded binds both signing parties, in the manner of a formal contract.

2. The mechanism was invented by the French and applied, in the 1970s and the 1980s, to eight large public enterprises, all monopolies or oligopolies with heavy social service obligations. In 1983, the French government concluded thirteen CPs of a slightly different nature with nationalized industrial public enterprises. The concept has been exported; first to francophone countries in Sub-Saharan and North Africa -- with Senegal and to a lesser extent Morocco having the most extensive and lengthy experience with the process -- to several anglophone African countries; then to Argentina, Brazil, and Mexico in Latin America, and most recently, in some experimental efforts in Bangladesh and India. This paper examines in detail the French and Senegalese experiences, reviewing the objectives of the CP process, where these performance agreements have been applied, with what results -- economic, financial and institutional -- and what lessons have been learned. Several other cases of CP use receive a brief review. They are either too new or too few to be analyzed in depth; though the promising Moroccan situation is given some attention. There are roughly one hundred public enterprises in developing countries that have CPs, and another one hundred are in preparation. The World Bank is presently supporting the process in over fifty enterprises in ten different countries.

## II. The French Experience

3. The first two CPs -- then called "program-contracts" -- were signed in 1969-70; with the national electricity company and the national railway. They defined objectives, and quantified financial performance targets, for the firms for the five year period of the agreement. Agreement on objectives was reached through a process of negotiation between government and management. The basic idea was that if goals were both agreed upon and clearly set, then government could lighten its time-consuming a priori controls, provide management with efficiency-enhancing autonomy, and evaluate the firm on the basis of achievement or non-achievement of the set goals. They stipulated significant rate hikes and called for increases in managerial autonomy on personnel and pricing decisions.
4. In the first half of the contracted period, results were positive. Budgetary aid to the two declined by 20 percent in the period 1970-72. This was encouraging; the budgetary burden issue was the one which most interested the French government of the day (and it remains the issue for LDC governments using the device). The rate increases in electricity were sufficient to allow the utility to cover its variable costs, in the period 1970-73, plus meet two-thirds of the finance charges on new investments. Managers and government supervisors agreed that goals had been clarified, transparency of operations improved, and government reviewers realized that increased management autonomy did not automatically mean increased waste. These were advances.
5. But the first "oil shock" of 1973 led to increased costs of inputs, inflation, a snap political decision to build several nuclear generating plants -- and all the elaborately prepared ratios, financial projections and investment targets of the CPs suddenly were out of date. The performance-guiding capacity of a CP is tied to the accuracy with which it predicts and projects key financial and economic variables. The greater the discrepancy between assumed and actual circumstances, the less the CP can serve as a detailed guide for management or evaluators. A second serious and recurring problem in France was government's refusal to permit service and staff reductions and price increases necessary to cover costs; even though the right of management to impose such changes was either implied or directly stipulated in the agreements. Faced with a widening gap between the projections of the CPs and actual performance, the contract with the electricity company was not renewed. The railway contract was "extended" for a two year period, but not immediately re-negotiated.
6. No other CPs were signed till 1978-79. Then four public enterprises were submitted to the process: the national coal company, Air France, the General Maritime Corporation, and -- the only repeater from phase one -- the railway. In an attempt to deal with the difficulties encountered in the first group, the timetable of the second group of CPs was reduced from 60 to 36 months. Annual revision was built in. The basic goals were repeated: to allow enterprise management more freedom to set

prices, reduce the workforce, end unprofitable product lines and close consistently money losing operations. Heightened emphasis was placed on costing out and compensating for socially imposed objectives. Technical innovations, mainly quantified physical and financial indicators to serve as measures of performance in monopoly utilities, were introduced.

7. Once again, implementation got off to a promising start. The coal company broke even in 1980, for the first time since 1951. Railway operations became more transparent through application of the performance indicators. The shipping company was committed to a reduction in its workforce by 25 percent, and a reduction in its fleet by over a third. (It was threatened with liquidation if it did not comply.) Air France had -- and continues to have -- the most positive CP experience. As it operated in basically competitive markets, commercial profitability was a more accurate measurement of performance. Thus, goals were more easily quantified, managerial autonomy more easily accorded, and deviations from commercial operation more easily demarcated -- and compensated. Targets were set for operational growth rates, financial objectives, and key physical indicators.

8. The Socialist victory in 1981 brought a halt to the implementation of several aspects of the CPs. Prices were not raised for rail services, a decision was made to re-open some unprofitable rail lines which had been closed, the shipping company retained its full workforce, the threat to liquidate the company was dropped. The basic assumptions of the second group of CPs, save for Air France, were simply revised from above. The Socialist government then negotiated some further "traditional" CPs with utilities or social service providers such as Gaz de France, the electricity company (II), Air France (II) and the railway (III). In 1983 the government also negotiated new-style CPs with thirteen industrial and manufacturing SOEs. These were, supposedly, guidance and orienting mechanisms; operational tactics were to be left to boards and managers. These CPs placed less emphasis on productivity and financial targets and more on new product lines, R & D efforts, market shares, and general harmonization of the efforts of these companies with the general goals of technological modernization and enhanced international competitiveness.

9. Despite the CPs, net transfers to all public enterprises increased from 12.8 billion francs in 1975 to 49.5 billion francs in 1982. In 1984, the French government reviewed their experience and offered five main lessons: (a) keep CPs short and simple; (b) keep them flexible; (c) "the existence of the contract-plan is more important than its content" (meaning that the formalized, periodic exchange of views between government and firm were more important than the quantified indicators or performance goals; the process more important than the product); (d) the weaker the performance of the enterprise, the greater the difficulty of negotiating and implementing a CP; and (e) the agreement is not really a contract for the reason that the state cannot be subjected to legal proceedings, by the enterprise, in the event that it fails to honor its obligations.

10. There have been no studies comparing the performance of French SOEs before and after the introduction of CPs; nor has a comparison been made between firms with and without CPs. Assessments have tended to be of a narrative, qualitative nature, polling the attitudes and opinions of managers and government supervisors with regard to CPs; they have concluded that concerned personnel support strongly the device. The French have invested considerable resources in CPs. In most instances, performance has not improved dramatically (though Air France has performed well under its CP regime). Too much was expected of the process at the outset; and the CPs inability to protect the SOE from the effects of uncertainty has been a disappointment to its originators. Recent French CPs have been short, general documents, outlining general policy rather than specifying the details of performance. The apparent failure of the mechanism to stem the budgetary outflow has led the managers of the process to scale down their ambitions regarding the utility of the CP device.

### III. The Experience of Developing Countries

#### Senegal

11. The CP process was introduced to Senegal in 1980, in the framework of a World Bank supported technical assistance project to the parapublic sector. The first five performance agreements were prepared between March of 1981 and January of 1982. In 1984, having reviewed the first experiences, the government decided to renew and expand the process in nine enterprises, and to consider the possibility of extending the device to many other concerns -- mostly utilities and agricultural development agencies, but some financial and industrial enterprises as well. As of May of 1988, CPs have been signed in nine different agencies. Three of the nine are now in their second CP, meaning that twelve sets of negotiations have been concluded. Senegal thus has the most experience with CPs of any country other than France.

12. The Senegalese make a distinction between CPs and "lettres de mission" (roughly translatable as "statements of objectives"). The former are used in public utilities and industrial enterprises; the latter have been applied to rural and regional development agencies, the commercial nature of which is more limited. Of the first group of five agreements negotiated in 1981-82, three were never implemented due to the lack of promised investment funds (a scarcity heightened by the decision of the World Bank not to release the second tranche of Senegal's SAL I). The first CPs followed the French models, stating the purpose of the enterprise, projected performance, and obligations of the government. But from the outset the Senegalese agreements had to deal with an issue which was not a serious problem for the French; i.e., the question of arrears between the government and the SOEs, and arrears among the SOEs themselves. The first CP for the urban transport company, for example, specified that government would settle its unpaid bills, and previously promised, but partially paid or unpaid subsidies. This issue was and remains a major

problem. In almost every case, the Senegalese government has committed itself in a CP, and then failed to inject promised amounts of equity, or failed to settle its arrears to the firm, or failed to pay off subsidies promised in the past, or failed to allow price increases, etc.

13. The weakness appeared principally to lie in inadequacies of the budgetary review and resource allocation processes. That is, individual CPs specified the steps needed to put a firm on a sound footing, particularly with regard to financing. The government largely accepted the CPs as drafted, and signed them, but then eventually found that it had nowhere near the resources necessary to cover the aggregate commitments made in the CPs. Resource dispensers then resorted to partial payments, with the sums and recipients being decided by the political process. Thus, the quantified goals set in CPs were all too often set aside; CPs proved not to be successful as detailed guides on operations at the level of the firm. They did, however, clarify goals and stimulate the dialogue between management and the state. This was beneficial; and associated with the CP process was a series of reforms -- management information systems, improved accounting and audit systems, the introduction of physical and financial performance indicators -- which lay the base for longer term improvements.

14. The second, or post-1984 generation of Senegalese CPs has been constructed to deal with the high degree of financial uncertainty which prevails in the country. With World Bank support, efforts have been made to strengthen the agency in the Office of the President which is responsible for SOE reform in general and the CP process in particular. CPs have included sections detailing the schedules by which the government would clear past financial commitments, and stipulating what services would be reduced in case of non-payment. A high-ranking inter-ministerial review body was created to monitor each CP, and lobby for the resolution of financial problems, if and when they should occur. Most of the most recent CPs include statements committing the government to ear-marking sums in the annual budget to cover most if not all of the average annual payments made by government for the good or service provided (water, electricity, telephones, etc.).

15. The CPs have produced a number of positive and beneficial results. Government supervisors and enterprise managers alike strongly approve of and support the CPs, and the open dialogue process which creates them. A late 1986 Senegalese assessment stated that firms with CPs show better personnel management, a superior capacity to estimate investment needs, more success in gaining approval for rate increases, and improved relations with suppliers of inputs -- resulting, in several cases, in lower prices for these inputs. Another study suggested that enterprises with CPs had higher rates of growth in turnover and lower labor costs than firms without CPs. There was no difference in profit-making or rate of return on equity invested. (The study had a number of methodological shortcomings; the positive results -- modest as they are -- must be interpreted with caution.)



16. Despite advances, the number and intensity of problems are greater than those of the benefits. For example, CPs are intended to promote managerial autonomy, but in Senegalese practice, managerial latitude remains quite limited. As performance evaluation and stimulation mechanisms, CPs should link an enterprise's results to rewards and sanctions for management and the workforce. This has not been done. Above all, the financial problems noted above have not been overcome. The government has, in all too many cases, consistently been unable or unwilling to meet its obligations, despite their supposedly contractual nature, and despite the corrective mechanisms enacted. The fact is that, as in France, the CPs are not true contracts; the enterprises cannot take legal action in case of non-compliance.

17. The state's failure to pay became so widespread that SAL III (1987-88) made the settlement of the state's obligations, as set out in existing CPs, a condition of second tranche release. Government only managed to meet the condition, at the very last moment, by unilaterally decreeing that the sums given in the existing contracts were all revised downwards, thus allowing the state to claim that it met the financing conditions. This tactic negates the basic principle of the contract-plan process; open negotiation of "les engagements reciproques" (mutual commitments). Most of the CPs produced have been technically competent documents. But despite the CPs and the pressure to honor them coming from the Bank, neither Office of the President reviewers, nor Ministry of Finance or Plan reviewers have been able to aggregate all the resources committed in the individual CPs and match them to overall resource availability. This is not to say that all the problems are the fault of government; it is rather that the CP process highlights government's deficiencies.

18. Suggested ways to improve the situation include: divestiture of part of the sector, allowing the government to concentrate scarce resources on a smaller number of enterprises; overall reduction in the budget of the resources devoted to SOEs, thus forcing a priority ranking of actions (this is being done through the SAL process); involvement of Treasury officials in the CP negotiations; publication by the Ministry of Finance of a formal payment timetable for each CP; procedures whereby the Ministry of Finance at least informs SOEs when payments will be partial or delayed; simplification of paperwork on claims and payments; closer links of SOE payments and the budget cycle; and, finally, the formation of new, high-level committees to monitor the payments process. All of these avenues are being explored.

19. Senegalese CPs might have avoided some implementation problems had there been a stronger supervisory unit. Though perfectly placed at the apex of power in government, the Contract-Plan Cell (or Supervisory Unit) has failed to exert sufficient pressure on budget and disbursement offices to persuade them to make promised payments on time, in the required amounts. One problem has been rapid turnover of its leadership, a second the junior status and lack of experience of its cadre. In 1987, the unit

was reorganized and given expanded powers; however, it still needs internal reinforcement and a clear division of labor with other supervising units, especially in the Ministry of Finance.

20. The primary lesson is clear: contract-plans cannot by themselves overcome the several, serious problems of the Senegalese parapublic sector. Weak budgeting systems (meaning a lack of reliable information on either the availability or the liquidity of funds), weak agencies of review in the technical and financial supervising ministries, and weak commitment to the concept of financial discipline -- the CP process highlights these problems, and shows that they are not all the problem of management; but it does not eliminate them. The CP is meant to be both binding and a plan. But the Senegalese experience reveals the difficulty of binding the government, and of constructing a plan that is both realistic and implementable. In miniature, the informational shortcomings of comprehensive planning are reproduced in the CP process.

21. Senegal, and other developing countries using the device, cannot easily adopt the French method of solving these problems; i.e., by moving away from comprehensive CPs towards shorter, more general statements of intent and broad policy. The French idea is to maximize the benefits of mutual goal-setting and formalized dialogue, which the process provides, without becoming bogged down in specific numbers and quantities. Senegal is obliged to retain a greater degree of complexity in its contracts. There the trend has been to use shorter intervals of CP review and modification, and to strengthen the reviewing agencies, in an effort to deal with the prevailing high degree of uncertainty. Irrespective of continuing problems, the World Bank continues to be heavily involved in the CP process. The reasoning is that the CP's emphasis on clear goals and on increased transparency of operations could and should, in the medium term, render important, low-cost assistance in the search for more productive and efficient public enterprises. CPs cannot make governments manage more rationally their resources; but they can provide, and are providing in Senegal, rationalist reformers with the ammunition to structure and legitimate reform.

#### Recommendations for Senegal

22. The CP process has little meaning if the State consistently makes unrealistic financial promises which cannot be kept. Three sets of action should be taken.

- (i) The cost-reduction and cost-recovery measures already set forth in existing CPs must be enforced.
- (ii) The links between the resource allocation -- i.e., the budgetary -- system and the CP process should be strengthened.
- (iii) A strengthened capacity within government, particularly in the Ministry of Finance, to project total resource availability, and to rank technically priority areas for expenditure, is essential.

### Other Developing Countries

23. The CP or a related mechanism is in use (or in preparation) in a number of other countries; most, but not all francophone African. Many of these CPs have been required or requested in Bank projects or adjustment operations; most of them have been prepared with technical assistance personnel paid by funds provided by World Bank credits. Benin, Burundi, Congo, Cote d'Ivoire, Gambia, Madagascar, Mali, Morocco, Niger and Tunisia: all have CPs in place or in preparation in Bank-related operations. In none of these cases has the CP process been in place for a sufficient period of time to permit a full assessment.

24. Still, the Moroccan case offers some encouraging signs. Learning from a trial run in their national airline, which had a CP from 1982-84 (but was never re-newed), the Moroccans are presently installing CPs in six major SOES, including the national electricity company, the water company and the railroad. Two of the six, including the water company, were signed in December of 1987; the remaining four are scheduled for signature by the end of 1988. Completion of all six is a condition of second tranche release of the World Bank's Public Enterprise Restructuring Loan (PERL) to Morocco.

25. The failure to honor financial obligations was a major problem with the airline CP. The clearance of arrears and the imposition of financial discipline are the goals of the PERL. Attention to financial details thus occupies a central position in the Moroccan CP process. But neither the involved government staff nor enterprise officials regard CPs as ultimate solutions or as rigid and inflexible documents. They are seen as first steps in a lengthy, experimental process, during which both sides will learn. No consultants, foreign or domestic, have been involved. Moroccan planners feel that it is better to have imperfect documents, the preparation/learning benefits of which accrue to Moroccans, than technically perfect CPs, prepared -- and understood and supported -- only by consultants.

26. Though the first two CPs signed in the framework of PERL have only been in effect for a few months, the state has cleared the arrears situation in these two firms, for the first time in the 1980s. Enterprise officials attribute this to the CP process, which gives quasi-legal force to the state's promise to pay, and to the firm and persistent action of the supervising agency, which has actively pressured the Treasury to honor contracted obligations. This is a substantial accomplishment. A concern is that neither CP eliminated or drastically revised the powers of the accounting agent or financial controller; officials of the Ministry of Finance who reside permanently in each SOE and whose approval is necessary -- and sometimes difficult to obtain -- for expenditures. It was thought and hoped that the CPs would lighten their role; this has not yet happened.

### III. Conclusions

27. In both France and developing countries CPs have been well crafted. Problems have been more in implementation than in design. CPs have not proven to be particularly good at restoring basic health to enterprises in crisis, to the point where the French -- and increasingly, the World Bank -- now recommend that enterprises first be rehabilitated, then submitted to the CP process. Developing country users of CPs have more often tried to apply the device to ailing firms, with disappointing results. The CP is best used to regularize and improve the framework for firms operating in basically commercial situations, endowed with decent management and sound financial and reporting procedures. It is not the mechanism of choice for healing a sick company.

28. The CP process requires a strong, well-placed supervisory agency to assist in the preparation of the agreement, review implementation, and especially push for the proper fulfillment of the contract. A difficult task is finding the proper balance between empowering the managers through the CPs, and at the same time endowing an oversight agency with sufficient "clout" to enforce the CPs. The hope of the creators of the CP process was that it would lead to a reduction in the powers of government supervising agencies. This has not come about, first, because of a normal reluctance of governments to diminish their prerogatives, and second, due to the unforeseen need to have a strong voice inside government pushing for the honoring of commitments. The latter is legitimate, the former unwarranted: CPs should replace normal control agents and procedures, not be added to them.

29. Despite the name, CPs have not proven to be legally enforceable contracts. If governments are not legally bound, what is the status of the obligations imposed on the enterprises? Persistent non-compliance with terms of the CPs has discouraged and demotivated enterprise managers. A frequently suggested reform is requesting or requiring governments to treat the terms of the CPs as legally contracted, with either party being able to enforce compliance through the courts. This is unrealistic. Governments already have the power to impose their will on enterprises, and none has shown any willingness to allow itself to be sued. Perhaps the term "contract" should be eliminated from the process; the more accurate term would be "performance agreement," a title already used in Latin America and anglophone Africa.

30. Overall, the CP device is of value, but its benefits have been a bit oversold. Government officials and World Bank staff contemplating its introduction should thus exercise caution. Ambitions should be modest. CPs should be introduced in one or two test cases. They should be kept short and simple. Emphasis should be placed on goal clarification, an increase in managerial autonomy, and open negotiating between government and management. CP use should not be a matter of conditionality in Bank adjustment operations; at least until the process has been tested in-country and shown to be workable and beneficial.

Contract-Plans:  
An Assessment of Their Utility as Performance Improvement  
Mechanisms in Public Enterprises

I. Introduction

A. The Issue

1. Contract-plans<sup>1</sup> are negotiated agreements between governments, acting as owners of a public enterprise, and the enterprise itself. The essential idea of a contract-plan is that the rights and duties of both parties are clearly spelled out. The concept was devised to attack the problems of unclear or shifting objectives, insufficient autonomy of managers, and excessively constraining control systems, problems perceived as major hindrances to public enterprise efficiency and productivity.

2. A contract-plan sets out, on the basis of negotiations between government representatives and enterprise managers, the intentions, obligations and responsibilities of the two parties. Its period of activity extends beyond the budgeting cycle, covering three to five years. A typical contract-plan specifies enterprise objectives, in terms of

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<sup>1</sup>/ Terminology varies from country to country or from period to period within the same country. These agreements are also known as enterprise contracts, program contracts, performance agreements, or action plans. The underlying principle -- mutual specification of rights and responsibilities by government and public enterprise -- is the same in all cases.

desired overall socio-economic impact, production goals, and/or quantities and quality of service to be provided during the period of the agreement. It defines policies and parameters with regard to such items as numbers employed, size and growth of the enterprise's wage bill, and social, or non-commercial activities. Many recent contract-plans stipulate the physical and financial indicators which will measure enterprise performance. What distinguishes the contract-plan from a set of directives imposed by the owners of a firm, or from a corporate plan produced by the firm on its own, is that it also spells out the obligations of, and limitations on, the government. That is, contract-plans normally define what management may do without government's review and approval, what prices the enterprise can charge for its goods or services, and how, and under what conditions, these prices will fluctuate. Many establish the principle that government will compensate the enterprise for costs incurred in fulfilling non-commercial objectives, and specify the means and mechanisms by which the compensation will be made. A typical contract-plan lays out the enterprise's financing and investment program, noting the amount the enterprise must generate internally, the amount to come from government subsidy or equity injections, and the amount to be raised by credit, with or without government guarantee.

3. Historically, elements or precursors of the contract-plan process can be found in a number of countries, but the device first came to prominence and fruition in France in the late 1960s and early 1970s. From 1970 to the present, a group of eight of that country's largest and most important (from several points of view, including degree of burden on the budget) public enterprises have been submitted to varying forms of what the

French call "the contractualization process." The test cases, in the energy, transport and utility sub-sectors, have all been monopolies or oligopolies with heavy social service responsibilities. In 1983, following the Socialist electoral victory, thirteen further contract-plans were concluded with industrial public enterprises, a few of which had long been in the public sector, but most of which had been nationalized by the Mitterand government in 1981-82. The results of both of these experiences have been judged as moderately positive, though the criteria used to make this assessment have been more institutional/managerial and qualitative than economic and quantitative in nature. Finally, French analysts are at pains to point out the difficulties of determining the exact relation between shifts in enterprise economic and financial results, and the presence or absence of a contract-plan (henceforth, CP).

4. Given the provenance of the mechanism, it is not surprising that the developing countries which have attempted to borrow or adopt the contract-plan have been, in the overwhelming main, francophone. The first recorded attempt to export the process was in 1973, when negotiations produced a CP for a Tunisian public textile firm. For unknown reasons, the agreement was never signed or implemented. But, starting in Senegal in 1980, and spreading through most of francophone Africa up to the present, the CP has been adopted, or is in the process of being prepared, in roughly seventy-five public enterprises in ten different francophone Sub-Saharan countries. The process is advanced in Morocco, where six CPs are presently being installed in a group of the most important PEs. The device is again being applied in Tunisia. In many of these instances, World Bank

structural adjustment or public enterprise reform programs have supported, and increasingly required, the installation of CPs.

5. Variations on the CP theme are in preparation in three anglophone African countries as well. Outside the African continent, the necessity to improve the performance of public enterprises has combined with the hope that the CP or something like it would effect desperately needed improvements, where so many other procedures and reforms have failed. This has led to the adoption, or consideration of a CP process in Argentina ("program agreements," in negotiation and preparation in the transport sector), Mexico, Bangladesh, India ("memoranda of understanding" in six major enterprises in the energy, industrial and engineering sectors), and inquiries into the prospect of using the CP in a number of other countries. Worldwide, there are over a hundred contract-plans in operation or advanced preparation, and an equal, probably larger number, under active consideration.

6. The purpose of the present paper is to examine the contract-plan experience; to determine what they were designed to achieve, how they have been constructed, where they have been applied, with what results -- economic, financial and institutional -- and what lessons have been learned. The study's major concern is the utility of the device as a way to improve performance in developing country public enterprises. Most of the available information on that subject comes from Sub-Saharan Africa, much of it from Senegal, the country most experienced in its use. The study thus examines in detail the Senegalese experience, and reviews more briefly the CP process in other African countries, Morocco and India.



However, the seminal nature of the French experience necessitates that the first order of business be a review of the CP process in that country.

## B. The French Experience

7. Throughout the less-developed world, governments have relied heavily on public enterprises<sup>2</sup> as tools to accomplish their developmental objectives. The use of public enterprises has not been limited to developing countries; most developed countries have had, and retain, substantial PE sectors of great economic and financial importance.<sup>3</sup> French PEs, before 1981, employed 12 percent of salaried workers outside agriculture, contributed 13 percent of value added, and accounted for 30 percent of gross fixed capital formation. All three ratios rose substantially after the nationalizations of 1981-82; all three have declined, perhaps to less than 1981 values, following the 1986-87 privatization of thirty PEs -- with a further thirty-five supposedly to follow. Nonetheless, even when (or if) all scheduled privatizations are completed, the French PE sector will still account for a higher percentage of GDP than in most other industrialized countries.

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<sup>2/</sup> These are also known as state-owned enterprises, parastatals, public corporations, or government-invested corporations.

<sup>3/</sup> Worldwide, public enterprises account for about 10 percent of GDP; to give an idea of the LDC's heavier use of the device, note that in Sub-Saharan Africa the figure is roughly double the world norm.

8. The French public enterprise sector came into existence following World War I, and underwent surges of expansion in 1936 (the Popular Front), 1945-46 (the reaction to World War II), and 1981-82 (the nationalizations following the election of the Socialist government). There was no dramatic shift of policy in the period 1947-67, yet the sector expanded steadily in that period as many public enterprises created a large number of subsidiary or affiliated companies. In 1966, the Gaullist government, increasingly concerned with the poor financial performance and particularly the large deficits of the monopoly public service enterprises, commissioned a high level panel to review the situation. The result was the Nora report of 1967 -- named after the chairman of the commission, Simon Nora -- which first suggested the concept of the contract-plan (at that juncture called the program-contract).

#### The Nora Report

9. The Nora report portrayed the deficiencies of the French public enterprise sector in critical terms and tone familiar to those working on the subject in developing countries today. It deplored the poor state of enterprise accounts and budgeting systems, the enterprises' inability to finance their own investments, the ineffective, time-consuming, dirigiste systems of government control and supervision, the lack of clarity of objectives, the government's failure to award enterprises sufficient or timely tariff increases; and the resulting general transfer of the costs of running these enterprises from the users of the goods or services they produced to the taxpaying public at large.

10. The dual prescription for reform offered by Nora was equally familiar: it was necessary to clarify objectives and set commercial profitability as a fundamental aim. Principal sub-objectives would be to increase management's autonomy, and improve State/enterprise supervisory arrangements. The State should no longer supervise by means of direct "...commands, by a priori authorization, or by taking day to day decisions best left to managers, but rather by the clear setting of criteria and of the rules of the game." It was recommended that the costs imposed by social service obligations be determined, and compensation mechanisms created. A distinction was made between public enterprises operating in competitive markets and monopolies; the former should be lightly supervised while the latter needed stricter controls. Only the latter would be subjected to the CP process. But, argued the report, all enterprises, including monopolies, could benefit from increased autonomy.

11. The report devised the concept of "engagements reciproques" -- mutual commitments or obligations -- which lies at the heart of the CP process. The report suggested that through negotiations the two parties would reach a binding agreement stating what the enterprise would accomplish and what the State would do -- and not do -- to guide, support and evaluate the accomplishments. The result would be an appropriate balance between needed enterprise autonomy and government's legitimate right to assure accountability. Contracts were to be used to set appropriate levels of enterprise inputs and outputs, the amounts of capital subventions, borrowing limits, tariff parameters and wage bills, and determine the margin of latitude of enterprise managers and directors. The

reasoning was that if goals were clearly set, government could lighten its a priori controls. The social costs of the operation would become more transparent, and this would make easier the task of evaluating the firm. The expectation was that as public awareness grew regarding the real costs of the enterprise, then pressure would grow for the reduction of these costs. A higher percentage of the operating costs might then be shifted to users. This, in turn, would create pressure to increase competition between public and private enterprises. The report thus envisaged the evolution of a drastically changed public sector "mentality," where costs -- especially personnel costs -- would be reduced, technology would be modernized, and management methods would change. The contract process was to serve a key role in bringing about this set of improvements.

#### Implementation - First Phase

12. Preparatory negotiations for CPs started in 1969. The first two CPs were signed in 1969-70, with the national electricity company, and the national railway (respectively, Electricite de France or EDF, and the Societe National des Chemins de Fer or SNCF). Each was supposed to remain in force for five years. The 1970 contract-plan for EDF was considered as the model CP. It spelled out a system of lighter, more flexible government supervision which reduced the powers of the permanent representatives, within the firm, of the ministries of Finance and Energy (representatives of the financial and technical supervising ministries are present in every French PE; their presence slows decision-making and hinders the seizing of opportunities). The CP supported expansion by EDF into nuclear power

generation. An early draft called for large rate increases which would allow EDF to cover the heavy investment costs and still turn a profit. Analysts note that it was the Ministry of Finance which insisted that the final agreement hold price increases to less than increases in the CPI (similar to the RPI minus x pricing arrangement used in privatized British monopolies at present). Nonetheless, from 1970 to 1973, the selling price of electricity was sufficient to cover the variable costs of EDF's production, plus meet two-thirds of the finance charges on new investments.

13. But the 1973 first "oil shock" led to vastly increased costs of major inputs, economy-wide inflation, and a snap political decision to increase sharply the capacity to generate electricity by nuclear reactors -- which in turn meant a spate of loans and subsidies to EDF not called for in the CP. In the altered circumstances, it became apparent that many of the elaborately prepared numbers and ratios in the CP suddenly were dated and irrelevant.

14. In the first SNCF CP, signed in 1971, the goals were to reduce the railway system's deficit by cutting staff by 15 percent, and by giving the enterprise considerable latitude on rate setting. The full achievement of all the CP's objectives would have substantially diminished the rate of loss but not turned the SNCF into a profitable company. But even the modest financial goals set in the first CP were not attained. This was partly due -- again -- to unanticipated increases in the costs of major inputs. An important second factor was a lack of political willingness, when the crucial moments came, to tolerate the service and staff reductions and price hikes necessary to cover costs. Third was the railway's

inability to compete with truckers in goods transporting, which reduced demand for rail service below projected levels.<sup>4</sup>

15. The SNCF CP was nonetheless extended for an extra two years, running through to 1977. The rail system's financial difficulties were not resolved, as government repeatedly cited regional development policies or possible social tensions as justifications for inactivity on price increases and cost reduction measures, even though these had been agreed on in the CP.

16. Despite the bleak picture with regard to financial results, assessments of the first CP experience were positive. All those involved, enterprise managers and government supervisors alike, agreed that the institutionalized CP negotiating process did lead to clarified objectives and increased understanding of the constraints operating on the other party. Budgetary aid to the CP'ed enterprises declined by 20 percent in the period 1969-72; though it then shot up to historically high levels following the first oil shock. This was important, for the budgetary burden issue is the one which most interested the French government (and

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4/ This section on the French experience utilizes the following sources: Michel Durupty, Les Entreprises Publiques - Tome 2 - Gestion/Contrôle (Paris: Presses Universitaires de France, 1986); J. de Chalander, IGF, Ministère de l'Economie, des Finances et de la Privatisation, "Les Relations entre l'Etat et les entreprises publiques en France," mimeographed, Paris, 1984, and J. P. Anastassopoulos et J. P. Nioche, Entreprises Publiques: Experiences Comparees (Paris: F.N.E.G.E., 1982, especially Chapitre 1, pp. 19-55.

remains the issue for most developing country governments presently using the process). Transparency was somewhat increased, and government controllers recognized that "management autonomy does not inevitably mean waste."<sup>5</sup> These were substantial achievements. Still, much of the optimism, or idealism, with regard to forward budgeting and financial projections -- key considerations in a process which projected production, costs and investments for five years into the future -- had faded in the light of the unforeseen changes in the world economy starting in 1973. Some observers outside of government thus called the process into question on the basis that any CP was only as good as one's ability to predict accurately the economic future. It was clear that that ability was poorly developed. Others felt that the first experience, especially in the SNCF case, showed that government's power inevitably overwhelmed the enterprise; that is, when there was a dispute or a crisis, it was government's position which prevailed. This led some to believe that the concept was mis-named and perhaps unworkable. None of the observers discussed the time or resources devoted to the preparation of the CPs, which must have been considerable. A noteworthy fact is that neither of the two first phase CPs was immediately renewed (though the SNCF CP was, as noted, prolonged, and then went into second phase negotiations).

#### Implementation - Second Phase

17. The period 1973 to 1977 was one of acute economic crisis and uncertainty during which the CP process was not expanded; but as a modicum

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5/ Durupty, p. 368.

of stability returned the French government again turned its attention to contracts. Two follow-up committees to the Nora body were formed. They issued reports, judged to be "less imaginative and more pragmatic" than that of Nora, which modified the CP process in light of lessons learned. The first change was that of scaling down the time frame of CPs; from 60 to 36 months, with greater provision for annual revision as and when circumstances altered. The second change was that of tightening the focus of the CPs, which henceforth were to be based on three principles:

- transparence of social transfers; letting the public know who is paying for what;
- transparence of results of PEs; by publishing and publicizing performance statistics;
- transparence on investments, which henceforth had to be justified in cost/benefit terms.

The overall goals were repeated: to increase autonomy of management, allow the enterprises more freedom to set prices, reduce the workforce, end unprofitable product lines, and close consistently money losing factories or operations. Heightened emphasis was placed on costing out and compensating for socially imposed operations. To emphasize the shift in focus, these agreements were given a new name: "enterprise contracts."

18. Four of the supposedly new style (in reality, they did not differ dramatically from the earlier agreements) CPs were negotiated in the period 1977-79; all were signed in 1978 or 1979. The companies were: the national coal company, Air France, the General Maritime Corporation and -- the only repeater from phase one -- the SNCF. The coal company, Charbonnages de France, was given a freer hand in pricing. This was



combined with a strong demand for coal as oil prices maintained high levels; these factors led to the company breaking even in 1980, after adding in government's subsidy (since 1951, the accounts had not been in balance even with the subsidy). Company managers hoped that the CP would "put an end to the arbitrary regime" under which they had labored. The expectation was that ex post evaluation of results would henceforth replace detailed ex ante reviews and approvals. Management wished to gain the power to run the operation as a commercial firm; government's role would be to provide the company with access to sufficient investment capital to allow it to modernize key facilities. But with the election of the socialists in 1981 the company's top management was changed. The new managers simply ignored the conditions of the CP negotiated by the previous regime, and the new government reversed previous decisions to close several old, unproductive, costly mines. In the last year of the CP, government subsidies to the coal company grew rapidly.

19. The second CP negotiated with the SNCF gave limited power of price setting to enterprise management. The major innovation of this particular document was its use of quantified performance indicators, physical and financial, to be used in the evaluation of results and the rewarding of management. This feature has been widely adopted in subsequent CPs, in France and elsewhere. But management's latitude in price setting was marginal, and in a most important cost area, that of personnel, management was powerless. (French CPs do not normally tackle head on numbers or pay rates of personnel; except in the case discussed in the following paragraph these matters are handled by national conventions. The failure to deal directly with personnel issues has been a deficiency of the program.) In

the first two years of the CP several uneconomic passenger lines were closed, which led to an improvement in the financial picture. Here as well, however, the victory of the socialists led to a government order to freeze fares and to reopen most of the closed lines. Levels of subsidization grew; the financial situation worsened.

20. The shipping company CP was more of a restructuring plan than a contract; that is, it was a statement of directives, along with a warning of what would happen if performance did not improve. In essence, the company was viewed by government in 1979 as having too many advantages and workers, and the CP's goal was to suppress the former and -- in a rare move -- reduce the number of the latter. A capital subsidy was specified and the compensation policy for the money-losing Corsican service was established; but the main components of the CP were the directives to reduce the workforce by 25 percent, and reduce the number of ships from 98 to 36. The CP stipulated that if the goals were not clearly met in three years, the government could exercise a right to sell or liquidate the firm. Yet again, the 1981 election changed government policy; the CP was essentially abandoned and the company allowed to survive, apparently with the same number of workers.

21. The CP process in Air France was -- and continues to be -- a much more positive experience. This was the first CP in an enterprise operating in basically competitive markets. Largely because of this factor, the negotiated CP gave the airline a greater degree of managerial autonomy than was accorded other firms. Since commercial profitability was a fairly accurate measure of Air France's success, the goals of the CP could be

specified with greater precision. The deviations from commercial operation were also easily demarcated: the use of inefficient Caravelles and the Concorde, the splitting of Parisian service between Orly and Charles de Gaulle airports, the maintenance of certain lines with uneconomic load factors -- the agreed-upon compensation for these non-commercial activities imposed on Air France could be and was precisely calculated.

22. The targets set in the CP for growth in the level of operations, financial objectives, and for the key physical indicator of number of flight hours per year, by aircraft type, were met or exceeded in 1978 and 1979, and were just short of targets in 1980. The result was that the firm turned a profit in 1980; "one of the very few European airline companies to present positive financial results" in that difficult year. It is not clear from available documentation how the government's "capital endowment" to Air France figures in the calculation of profitability. Nor can one gauge the role of factors outside the control of management, such as the reduction in the price of fuel. Nonetheless, what is clear is that financial targets set in the CP were met or exceeded in each of the three years covered in the period. This was enough to term the process a success. Air France has had its CP renewed every three years since.

### Third Phase: 1981 to the Present

23. After 1981, CPs of a more or less traditional type continued to be installed in several of the monopoly or oligopoly public enterprises with heavy social service obligations: Gaz de France, EDF, Air France, and --

for the third time, following lengthy and difficult negotiations -- the SNCF. But in the first half of 1983 the Socialist government also installed what it insisted was a quite different type of CP in thirteen industrial and manufacturing public enterprises, several of which had been nationalized in 1981-82.<sup>6</sup> To show that the new contracts in the industries differed from past activities in the utilities, the agreements were, finally, given the name by which they are today generally known, "contract-plans." In these CPs, enterprises were to be given only guidance and policy orientation of a long-term, strategic nature; operational tactics were, in principle, left to managers and boards. (But similar promises had been made concerning the earlier processes.) The documents drafted did place much less emphasis on productivity and financial targets; they stressed instead the creation of new product lines, areas in which the firms would concentrate their R&D efforts, the maintenance or regaining of a set amount of market share, and, in general, harmonization of the efforts of this group of state enterprises working in basically competitive markets with the overall goals of the technological modernization and enhanced international competitiveness of French industry. The Socialists' conception was that CPs should link long-term performance of the enterprises to social aspirations outlined in the national plan.

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<sup>6/</sup> The thirteen were: CGE, Thomson, Bull, Renault, Usinor-Sacilor, CdF-Chimie, EMC, St-Gobain, Pechiney, Aerospatiale, SNECMA, Matra, and S.N.P.E. The last two firms produce armaments and are under the control of the Ministry of Defense; the first eleven are supervised by the Ministry of Industry and Research.

24. The CPs were negotiated with parent corporations; subsidiaries and affiliates were not dealt with directly. The CPs were designed to be all-encompassing; i.e., to replace all other forms and procedures of control. They were also supposed to be supervised by a single tutelle agency, the appropriate ministry of technical supervision. No other ministry or body was to play a direct role in the supervisory process. (Even the spokesmen for the system admit the difficulties of maintaining this position of each firm dealing with a single official interlocuteur.) Another difference in the post-1981 process was that, for the first time, workers' representatives were consulted and involved in the CP negotiations.

25. For several reasons, the impact of this last group of CPs is particularly difficult to judge. First, the details of these CPs were, at the insistence of the enterprises, kept confidential. There was a fear that competitors would reap unfair advantage by studying the details of the agreements. Thus, one cannot compare post-CP performance to the projections in the agreement. True, the essential features of the CPs were published in official documents and press releases, but the fact remains that the full texts are unavailable. Second, even if they were they would be of limited value as mechanisms to evaluate performance. As noted, this group of CPs concentrated on long-term and general objectives, not quantified short-term targets. It is only now, as one approaches the fifth anniversary of their signing, that one might be in a position to assess the achievements. But in the interim the circumstances have -- once more -- changed; first, with the return to parliamentary power of a center-right government, and second, in 1988, the re-election of Mr. Mitterand and the re-installation of a Socialist cabinet. The result has been the

reprivatization of several of these industrial units, the diminution of the importance of planning in the French system, and a general reduction in importance of the contractualization approach.

26. Following the wave of nationalizations and the drafting of the new CPs, the government took general stock of the public enterprise situation in the utility sector. The conclusions of its review were disquieting. Although the CP process had been brought into being to combat the poor financial performance of public enterprises, especially their persistent tendency to drain budgetary resources, net transfers from government to public enterprises had increased from 12.8 billion F in 1975 to 49.5 billion F in 1982. It appeared that these increases took place despite, not because of, the CP; it was argued that unforeseen shifts in economic and political circumstance had brought about the higher level of funding. But this excuse only seemed to illustrate the marginal nature of the CP. The implication was that CPs could do little to predict, much less offset, market conditions. This raised the question of whether the CP process has been worth the massive administrative and supervisory investment made by the French. At the core of the CP process is the capacity to project forward quantified statements concerning production, costs, investments, borrowing, wage bills, capital structure, etc. If unpredictable changes in political and economic circumstances invariably lead to targets, indicators, ratios and particularly commitments becoming irrelevant and untenable, then what is the utility of the exercise? What was the French government and public gaining from the exercise?

27. It was to combat this problem of coping with uncertainty that the second and third phase CPs had been reduced in length from 60 to 36 or at most to 48 months. Secondly, the Socialist government, in line with the philosophy shown in their industrial sector CPs, altered the objectives of the process. In essence, the government increased the social as opposed to technical content. The modified objectives of the CP process became:

- (i) assure coordination between the medium term objectives of the enterprise and the policy of the State;
- (ii) associate the enterprise in the "realization of objectives of national interest;"
- (iii) mobilize the personnel of the enterprise to support the defined objectives;
- (iv) allow autonomy of management; and
- (v) define and specify the financial relations of the enterprise and the State.

These goals were more general, less technical in nature, than those put forward by the ambitious Nora Report; and as such they were less likely to be called into question by shifts in economic conditions.<sup>7</sup>

28. The goals had been redefined in light of the four major lessons which had emerged from previous experience. These lessons were:

- a. Keep contract-plans short and simple. Initial attempts were too ambitious, long and complicated; they attempted to specify too minutely the economic future and the actions and

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7/ The lists of objectives (above) and lessons (below) are found in J. de Chalendar's paper, cited above in footnote 4.

reactions of the enterprise. The preferred CP became shorter, and concentrated on grand aims and principles.

- b. Keep CPs flexible. Every CP should be treated as a "sliding" or rolling plan; every aspect is subject to renegotiation for change if the numerous assumptions concerning future conditions prove inaccurate. CPs now have built-in provisions for review and modification on an annual basis; even more frequent review is possible.

- c. "The existence of the contract-plan is more important than its content." That is, the utility of the CP is less in its quantified performance indicators or goals and more in the formalized periodic exchange of views between government owners/supervisors and managers. It is the very process of being exposed to the other side's point of view while negotiating an agreement which is the major and justifying accomplishment of the contract-plan, even though the specific numbers produced in the exercise are sometimes misleading or outrightly incorrect. This is a very important finding; the activity is seen as beneficial in and of itself, not necessarily because of material outputs.

- d. Fourthly, in general, but particularly in periods of economic crisis, the weaker the performance of an enterprise, the greater the difficulty of negotiating and implementing a contract-plan. Negotiations with the SNCF for its third CP took close to two years, and produced one of the thicker and



more complicated of documents (31 pages of text, 44 articles, seven annexes). Negotiations with the national steel company took place over several years starting in 1979, but never led to the signing of a CP. Both were cases of generally weak past performance, combined with particularly high levels of uncertainty with regard to future demand. It would seem that there must be a modicum level of both economic stability and optimism concerning the future of the firm before enterprise officials can envisage committing themselves to a concrete set of short-term goals and obligations.

29. Finally, the reviewers recognized a fundamental problem with CPs, a problem that has proven even more intractable in the developing countries which have attempted to use the device: the agreement is not really a contract for the simple reason that the state cannot be subjected to legal proceedings, by the enterprise, in the event that it fails to honor its obligations. Repeatedly in France, this has proven to be the common case and the evident difficulty. The state could agree in the abstract to rate or fare increases, and even commit itself on paper, in a document modeled on the language of a legally binding contract, to grant firm X a tariff increase of Y percent at time Z. But all too often, when the moment came to honor the commitment, the political costs appeared to outweigh the financial and economic benefits. Thus, fare increases tended to be reduced or postponed, several uneconomic factories or lines slated for closure were kept open, the workforce in various firms was maintained at excessively high levels, etc. Enterprise management could negotiate, complain, bring to bear what external pressure they could muster, and threaten to resign to

force the point; but they could not invoke the powers of the judicial system. The CP is thus not really a contract; it is an agreement which is only as good as the degree of government commitment to it.

30. French analysts have tended to judge the utility of the CP process on the basis of whether the set targets -- physical, financial and social -- have been met, and whether the actors involved in the process, from both the government and enterprise side, have assessed the CP as being worthwhile. These are important issues, but they do not adequately address two fundamental questions: What has been the comparative performance of public enterprises before and after the introduction of CPs; and what has been the comparative performance of enterprises with and without the CP? On both of these critical counts, information is, at best, sketchy.

31. Before and after: As indicated, performance of a number -- though by no means all -- of the French public enterprises submitted to the CPs, at various points in the process, showed financial improvements. It seems reasonable to think that some responsibility for the improvements could be attributed to the CP process, for example, in Air France, EDF and Charbonnages de France. But in all but Air France, improvement was short-lived. Either renewed or unanticipated external shocks, or government failure to take or sustain cost-cutting or revenue enhancing measures, or both, usually intervened. This may indicate that CPs can only guide and positively promote enterprise activity during periods in which the initial set of assumptions holds true. It might further be argued that the period in which the CP process was introduced -- 1970 through 1984 -- was an extraordinarily unsettled period, economically and politically, and that it

was simply unlucky timing which accounts for the difficulty in comparing firm performance before and after the introduction of the CP. But this is not a particularly strong argument since all periods are unsettled to those living through them; politicians always have short-run survival interests which conflict with long-run economic gains; this is simply a constant. An ideal mechanism would deal with this uncertainty; though, admittedly, that is asking a great deal. A reasonable conclusion is that the CP seems to have been capable of influencing but not determining enterprise performance. It was of significant but secondary importance, and its impact was overshadowed by macro-economic changes and shifts in government policy and commitment. As is the case with most management improvement mechanisms which attempt to substitute goal specificity, set by administrators or by negotiation, for market mechanisms, the information problem quickly becomes overwhelming. That is, the beneficial impact is related to the degree of realism of the assumptions and projections contained in the CP. As external conditions shift, the assumptions no longer depict accurately the real economic world, and the directing force of the CP weakens.

32. As for with and without, the discussion is even more problematic. For example, to what does one compare EDF? The performance of other European electricity corporations? Or to some set of synthetically derived performance norms? Increasingly, it has been the latter measurement which is regarded as promising. However, it has been the CP process itself which provided some of the first attempts, in what remains a new field, to construct performance indicators of this type. Only in the case of Air France, which could use many straight-forward market signals as a guide to

good performance, can one trace out consistently positive financial results in line with the goals set in the CP. (An economic assessment would be much more difficult.) But this raises another question, i.e., to what extent can positive financial results be attributed to the existence of the CP? It could be argued that the prime factor which led to Air France's good performance in the early 1980s was the decline in energy prices, and that this price decline was external and had nothing to do with the airline's management or internal procedures. But other airlines also benefitted from falling oil prices, and most failed to translate this gain into a demonstrably improved financial position. In brief: Air France did fairly well when most European airlines, operating in roughly the same economic environment, did not. During the period of good performance Air France was operating with a CP when the other airlines were not. The CP was thus associated with comparatively good performance. To what extent was it responsible for it?

33. Available data do not allow one to say. The issue of assessing rigorously the economic and financial impact of the CP process is complex. The episodic experience of Air France, or the other seven enterprises, scattered over a seventeen year period, in a variety of activities, and operating in rapidly shifting policy and economic environments, does not add up to a comprehensive or rigorous test of the concept. Thus, an emphasis on whether physical and financial targets have been met, and the subjective assessments of whether or not participants approve of the process, is about all French observers reasonably could be expected to do.

Conclusions on the French Experience

34. The conservative government in power in France from 1986 to 1988 concentrated its energies on the privatization of public enterprises. They started the process with manufacturing and financial sector firms, operating in competitive markets, many of which had been nationalized by the socialists in 1981-82. Privatization was that government's economic preoccupation in the public enterprise sector; reform of PEs retained in State hands in general and concerns of the CP process in particular slipped to secondary importance.<sup>8</sup> However, all of the sixty-five firms -- the thirty privatized and the thirty-five additional firms which were to be privatized before 1990 -- are in competitive sectors. Unlike Great Britain, the French have no announced plans to divest the natural monopolies in the utility sector. This suggests that CPs, or perhaps yet another modified version of the CP, will continue to be used to guide, orient and evaluate the performance of major French public enterprises; a possibility increased by the results of the 1988 elections.

35. The French have invested a fair amount of administrative and intellectual resources in the CP process (though the marginal difference in administrative costs may be slight, since PEs were being extensively supervised before the introduction of the concept). In most instances, performance has not dramatically improved -- though note must be made of

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8/ A summary of the privatization experience, to the end of September, 1987, was written by the then Minister of Finance, Edouard Balladur: Je crois en l'homme plus qu'en l'Etat (Paris: Flammarion, 1987).

Air France's consistently respectable performance under the CP regime. Failure to improve performance may not be the "fault" of the CP; but the process's inability to protect the contracted public enterprises from the vicissitudes of uncertainty has proven disappointing to the concept's originators. In several French instances where performance has improved, either temporarily or enduringly, it is difficult to do more than correlate the presence of the CP with the improvements; one cannot say what percentage of the positive (or negative) variance is attributable to the CP. At no point in the process have the French attempted to link management or worker incentives with fulfillment of a CP's objectives. In France, this issue seems to have been generally ignored. Still, the actors in the process, managers and government supervisors alike, support CPs because they enhance the clarity of goals, the transparency of operations and achievements, and the ease of evaluation. These are advances. But, partly because the costs of creating the CP have not been calculated, one cannot tell if benefits justify the investment.

## II. The Experience of Developing Countries

36. As noted, the first recorded attempt to export the CP process was in 1973, in a single Tunisian textile public enterprise. It never proceeded to the implementation stage. The first concerted effort to replicate the CP process in a developing country took place in 1980-82, in Senegal.

A. Senegal

37. The Senegalese case illustrates the thesis that there are similarities in the problems faced by public enterprises in industrialized countries and in developing countries. The distinctions are mainly a matter of degree rather than of kind. Ambiguous or contradictory goals, politically determined deviations from profit-making or profit-maximization, efficiency-reducing bureaucratic control and supervision systems, financing and investment decisions based on inadequate or inappropriate analysis -- these and other deficiencies are seen in Europe as well as Africa, in North America as well as Asia. However, some aspects of these problems in developing countries are particularly intense. For example, rarely if ever would one find a European public enterprise failing completely to produce accounts, or being incapable of submitting accounts to auditors for several years running, or having no internal financial control systems, or not receiving payments, for its goods or services, from the government itself, to the tune of millions of dollars of arrears. Yet these difficulties are common in LDC public enterprises. It was to attack grave deficiencies of this nature, and to begin the process of resolving the large scale, systemic, economic and financial problems these deficiencies led to, that the World Bank and the Government of Senegal, in 1976, launched the preparations which would lead to the signing of a Technical Assistance Project to the Parapublic Sector. It was the first of its kind in Africa, and in the Bank.<sup>9</sup>

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9/ The details of the project, and an assessment of its accomplishments and shortcomings, can be found in the "Project Completion Report - Senegal - First Technical Assistance Project to the Parapublic Sector," World Bank, January, 1985.

38. A 1977 Bank review of the Senegalese PE sector had stated:

Supervision needs to be carried out on a contractual basis for enterprises to be able to manage themselves. Management by objectives could thus meaningfully be introduced under which each enterprise would negotiate with Government annually the targets to be set for it and would then be judged accorded to the results it achieved.

This idea was not pursued in the early stages of the ensuing project, which entered into effectiveness in 1978. It was not until 1980, and partly in response to the project-assisted improvement in the flow and accuracy of information on the poor performance of public enterprises, that the government decided to:

- adopt CPs,
- create a CP "Cell" in the Prime Minister's Office, and
- ask the Bank for assistance with this aspect of PE reform.

The objectives were the same as those which had inspired the French CP process: to clarify goals; to coordinate the various government supervisory bodies, which either offered conflicting directives or operated according to different schedules; and to commit both the government and the enterprise to a clear course of action which would result in higher productivity and lower costs.

39. Between March of 1981 and May of 1988, contract-plans were signed in nine different public enterprises. Since three of the nine are now in their second CP, a total of twelve sets of negotiations have been concluded. The first three Senegalese CPs (rural development agencies receive a more preliminary agreement, called a "lettre de mission," roughly



translatable as "statement of objectives") were prepared between March of 1981 and January of 1982, in SOTRAC, SAED and SODEFITEX. Respectively, these firms operated in the fields of transport, agriculture and rural/regional development. In 1984, the government decided to renew the process in SOTRAC, SAED and SODEFITEX, and to apply CPs to other major enterprises. CPs or "lettres de mission" were subsequently installed in SONATEL (telecommunications), SONEES (water), SENELEC (electricity), SOMIVAC, SODEVA and SODAGRI (agriculture/rural development). CPs are presently being negotiated in OHLM (housing), OCPE (post and savings), RCFS (railway), and PAD (the port of Dakar). Thus, in terms of number and range of types of PEs affected, Senegal now has the largest CP program in the world.

40. The 1977 diagnosis of the sector had revealed fundamental problems in a number of important PEs. In some cases -- SOTRAC and SAED for example -- it was thought that the installation of a CP would be the main improvement and restructuring method in and of itself. In other cases, most notably that of the telecommunications/post office, the OPT, it was decided that problems were so severe that reorganization should precede the application of the CP. In the case of the OPT, the result was a splitting of the firm into two enterprises, both of which (SONATEL and OPCE) were then subjected to the CP process. This raised a question which is not yet resolved: should CPs be used on the most severely troubled enterprises, or should their use be reserved for non- or mildly-troubled companies? Developing countries tend to use CPs as rescue devices for poorly performing firms, with questionable results. The Air France experience

indicates that their utility as improvement devices in basically sound, quasi-competitive firms has been insufficiently examined.

41. The first set of Senegalese CPs followed closely the French conception and practice. In line with the lessons learned in France in the 70s, they were fixed for three year periods. Good examples of the first group of CPs, illustrating the range of bodies to which the process was applied, and of subsequent implementation and modification problems, were the cases of SOTRAC, the Dakar region bus company, and SAED, the Senegal River and Delta Development Authority. (It must be noted that of the first three, only the SOTRAC CP was carried through to conclusion, while the SAED agreement came close; the third, and others which had been considered but never negotiated, were all dependent, for the funding of their investment programs, on resources to be made available through the first Structural Adjustment Credit, negotiated with the World Bank in 1981. Due to a dispute over agricultural prices, only the first tranche of this credit was released. Given the unavailability of funds, two of the first five CPs were never negotiated, much less implemented.)

#### The First Phase

42. The first Senegalese SOTRAC CP was a short document of eight articles, stating the purpose of the enterprise, the assets to be deployed during the period of the CP, projected performance, obligations of the government, and means of implementing and modifying the CP. SOTRAC's future position, the agreement stated, could only be secured by dealing with three critical issues: renewed investment in vehicles, a paying off

of the substantial arrears (1.1 billion francs CFA) in government subsidies, and government permission to increase prices. The agreement specified the three year investment program of SOTRAC, and projected a stabilization of losses, as opposed to substantially increased losses which might normally be expected during a period of massive reinvestment. Improvements were projected in the cash flow position.

43. The government's obligations were clearly spelled out. Government agreed to a precise timetable to pay off the arrears on previously promised subsidies, and to pay future subsidies according to a set schedule. SOTRAC was declared exempt from normal duties and taxes on the materials it imported. The national government promised to "do its utmost" to persuade the communal government of Dakar to bear some of SOTRAC's subsidy, maintain the regional road network, and assist in the construction and maintenance of SOTRAC's terminals.

44. A technical innovation of the SOTRAC CP was the use of three different pricing hypotheses. That is, during negotiations the government committed itself to allowing SOTRAC a price increase during the CP period, but government representatives were unable to specify the amount by which prices would be authorized to rise. The CP posited three different scenarios, which traced out differing financial results according to the amount of tariff increase allowed.

45. The CP covered the main issues of enterprise purpose, prices, investment capital, financial results and CP monitoring. It did not cover performance indicators other than net financial results. This was an

inadequacy; commercial profitability is an imperfect indicator of the performance of a monopoly, heavily subsidized public enterprise, especially one receiving the indirect subsidies mentioned in para. 43. (This shortcoming was corrected in the second SOTRAC CP.)

46. In contrast to SOTRAC, the CP -- termed a "lettre de mission" -- with SAED (the Senegal River and Delta Development Authority) was a long document, produced after complicated negotiations. Covering the period 1981-84, the agreement was more a restructuring device than a contract; its purpose was to resolve fundamental operational difficulties of an extremely expensive and inefficient rural development agency. This was the first time, anywhere, that the contract process had been applied to an enterprise of this type (though it is not clear whether the targets were negotiated, as they would and should be in a CP, or whether the goals were simply imposed by government directives). The document laid out a variety of quantified production goals for SAED: number of undeveloped hectares to be turned into farmland, number of existing farms to be expanded, and production and marketing targets for paddy, tomatoes and maize. The agreement dwelt on the reorganization of SAED, emphasizing the need for management information and budgetary control systems, rational personnel management and improved accounting and expenditure control, the details of which were spelled out. Government obligations were stated more vaguely: for example, the CP noted that the State "would be required to provide (SAED) with adequate working capital;" there was an admission that only half of the minimally essential investment funds were available, and that "Government now has to find the remaining 50 percent, i.e., CFAF 5.435 billion;" and on the crucial matter of farmgate pricing, the agreement was

less than legally precise: "Government will maintain producer prices at levels sufficiently remunerative not to interfere with debt servicing and sufficiently attractive to stimulate production."

47. The CP set out the schedule for government's quarterly subsidy to the enterprise, necessitated by "the difference between the billing rate set by the Government and the actual cost of production and services rendered;" and to cover those operations imposed on SAED "for which there is no billing provision." A second table presented the estimated payment dates for the clearing up of previously promised subsidies, now substantially in arrears. The document concluded with a statement that it was "binding on the two parties." It was signed by the Director General of SAED, the Chairman of SAED's Board, and -- for the government -- the Prime Minister, the Minister of Finance and the Minister of Rural Development. The letter of understanding had been conceived, prepared, negotiated and signed in a period of seven months. (This appeared long at the time; subsequently, preparations for most CPs have taken much longer.) The overall result was a document of some thirty pages, not including annexes, but with most of the specificity on the side of the enterprise's goals; the government's obligations remained vague.

#### Fundamental Problems

48. The initial experience with CPs was judged as only moderately positive. Management autonomy did not increase to the anticipated degree. The lack of physical performance indicators in the SOTRAC CP proved to be a problem, as did the shortfall in specificity of government obligations and

undertakings in the SAED agreement. However, from the outset and continuing to the present, the two more important problems with the CP concept in Senegal were: (a) the government's inability to keep its financial promises, and (b) the enterprises' -- and the supervising agencies' -- inability to force, pressure or cajole the government into honoring those commitments. In SOTRAC and SAED, and later on in almost every enterprise submitted to the CP process, the government committed itself in the CP and then either failed to settle its arrears to the firm, or failed to honor an agreement to pay off subsidy sums promised in the past, or failed to meet timetables on current subsidy payments, or failed to inject promised amounts of equity, or failed to give final approval to previously agreed upon investments, or failed to allow price or rate increases which would have increased the self-financing capacity of the enterprises. In most cases, a combination of these defaults was present.

49. Neither Government's lack of resources nor its lack of financial discipline was caused by the CPs; rather, the CPs rendered transparent and quantified government's shortcomings -- and it can be argued that these were necessary and progressive steps. Drawing attention to a problem is a step in overcoming it, but despite repeated flagging of the issue it remains unresolved to the present. The Government recognizes the problem; in its 1988 review of the "State of Application of the Reform of the Parapublic Sector," the chief PE supervising agency in the Office of the President stated: "Non-respect of the State's financial commitments remains the central problem with lettres de mission and certain contract-plans... The result is that the credibility of the CPs is weakened..."

50. The general lines of the problem would have been familiar to the French; but in the Senegalese case the difficulty was of a greater magnitude and intensity, in terms of the number of CP'ed enterprises in such difficulties, and the size of the gap between what government had said it would do, and what it actually did. Several factors contribute to this problem. First, the entire Senegalese planning tradition and experience has consistently tended to produce extensive and ambitious lists of desirable activities, without sufficient specificity on where the money will come to pay for them.<sup>10</sup> CPs have proven to be but another example of this well-entrenched process. A second factor contributing to the financial unreality of the CPs has been that they were all produced, in first draft form at least, by consultants who naturally attempted to produce agreements which would improve the position of their main client, the firm to be CP'ed. Moreover, and again naturally, they were produced in isolation one from the other; no drafter of one CP knew the budgetary implications of any other CP. Thus, the draft CPs tended to specify financial conditions which would allow the firm to carry out what management and the drafting consultants saw as the enterprise's mandate. The viewpoint was that of adding all resources necessary to rebuild the enterprise; the notion of what the State could afford was secondary, if taken into consideration at all.

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<sup>10/</sup> See Pierre Guislain, "Les Contrats-Plan dan les pays en developpement: Un moyen d'organiser les relations entre le gouvernement et les entreprises publiques en vue d'ameliorer les performances desdites entreprises," World Bank, LEGWA, May, 1987.

51. The first level of review for the draft CPs is, theoretically, in the technical ministries. Officials and managers interviewed state that technical tutelle ministries almost always approve, without question or deletion, whatever proposals are put forward by the consultants/enterprises. No global consideration of what Government can afford takes place at this level. Indeed, one could argue that it is unrealistic to expect the technical ministries to restrain the growth or operations of "their" enterprises; that they are quite content to see their PEs expand. This means that responsibility for global consideration of the aggregate financial impact of the CPs rests with the central agencies, the Delegation for the Reform of the Parapublic Sector in the Office of the President, and the Parapublic Sector Cell in the Ministry of Finance.

52. These bodies have not done their job. These central reviewers have tended to:

- accept uncritically the draft CPs. At first, they often failed to appreciate the financial implications of the agreements, individually much less than in the aggregate. The resource implications surfaced later, and either delayed the signature or implementation of the CP, or only became apparent after signature, leading to problems discussed below.

- More recently, Ministry of Finance reviewers of CPs have recognized that financial commitments called for in some CPs were unrealistic or excessive. They have made note of their concern, and called the attention of higher officials to their view. However, they have been told that they must approve and sign the CPs, even though they know the promised resources will not be available. The justification has been that the political situation requires the signature of the obviously unrealistic



document, and that the resources might surface (from some unspecified source) during the course of the CP.

53. In short, central officials have regularly approved expenditure forecasts which, when summed, far exceeded government's resources. They then applied what one might call traditional budgeting techniques, which can be summarized as: use whatever resources are on hand to deal with the most acute crisis, as determined by the political process or leadership; ignore previously determined budgets, agreements, commitments, contract-plans, etc., and give the squeakiest wheels the smallest amount of oil which will quiet them for the moment. The CPs were supposed to solve this problem but they did not, due to the simple fact that the CPs, taken together, committed the government to spend far more money than it had available.

#### Evaluation and Revisions in the Process

54. Despite the overall financial problems, can one perceive differences in micro-performance between enterprises with CPs and those without? Only one study has been undertaken which attempted to compare results. Performance of the first six PEs with CPs was contrasted to the performance of a group of eighteen non-CP'ed public enterprises. The analysis reviewed the period 1980-83. Both groups ran losses in these three years; and both groups reduced their rate of loss by about the same percentage at the end of the period. Perceptible differences occurred in only two areas: the contracted PEs had a growth in turnover of 93 percent in the period, as opposed to 66 percent in the non-contracted firms; and

personnel costs rose 13 percent in the contracted firms, versus 45 percent increases in the non-contracted enterprises. Levels of debt reduction were about the same in both groups. For several reasons, these moderately positive results have to be interpreted cautiously. First, the indicators showing variance are of secondary importance. The major performance indicators of profitability, self-financing ratios and return on capital invested were the same (and poor) for both sets of firms. Second, the differences seen are of questionable size and significance. Third, the period reviewed was quite brief. Fourth, the enterprises compared differed greatly in structure, purpose, market position, etc. It is difficult to argue that like was being compared to like. Nonetheless, despite the drawbacks of and qualifications to this study, it deserves praise as the only attempt to assess quantitatively the impact of the CP. More and better studies of this nature are required. It would be very useful to mount a detailed comparison of performance of firms with CPs as opposed to those without, as well as a comparison of performance of enterprises before and after the introduction of CPs.

55. Regardless of the lack of major improvements in performance, and as was the case in France, Senegalese managers and government supervisors working with CPs have almost universally concluded that they are beneficial devices, the use of which should be continued. Interviews with eighteen Senegalese officials and managers, concluded in January of 1986, indicated strong support for the CP process. Managers approved of the heightened clarity of goals, the specification of government's financial responsibilities, and the concept of government compensation for non-commercial activities imposed on the enterprise. Officials saw the major

advantage as the increase in the autonomy and responsibility of management. (One could argue that both groups liked those features which highlighted the responsibilities of the other party.) Indeed, all involved parties, including project officers from the World Bank, have found the CP irresistibly appealing. In theory, it clarifies objectives, determines priorities, allocates resources, guides and stimulates productive behavior and eases evaluation.

56. The CP appears to be the perfectly logical response to an intractable set of problems and needs. Though its application has failed, at least in the short run, to produce dramatically improved performance, it is nonetheless regarded as a worthwhile innovation because of the constructive dialogue it creates between managers and owners. The problem is that CPs do not force financial discipline on the government. In response, the tendency has been to shift the criteria by which its utility is judged (as in France), or to hope that modifications will increase its impact (the Senegalese approach).

#### The Second Wave

57. The workings of the second group of CPs (see para. 39) showed a continuation of the problems. (In the case of SENELEC, the CP was not signed until 1987.) The SONEES example, while perhaps something of an extreme case, reveals the workings of the process. The main features of the agreement were increases in the tariff structure, and a rehabilitation/investment program, to be funded through settlement of the government's outstanding debts to the company. The functioning of the CP

was subjected to a review at the end of 1985. Major difficulties were apparent. In the review period, despite the enactment of the price increase, revenues of SONEES were 16 percent lower than anticipated; costs 5 percent higher. But the critical problem was the usual one: "neither the State nor the local governments have respected their commitments" to settle outstanding accounts. The result was a deficit five times greater than anticipated, and a reduction by half in the essential rehabilitation/investment program.

58. As of June, 1985, the total public agency debt to SONEES was 5.5 billion F CFA. The company's financial situation was desperate. Operating costs were being financed by short-term bank overdrafts, at high interest rates. Suppliers were demanding higher and higher advance payments, or adding substantial "waiting premiums" to their bids, or -- most commonly -- simply refusing to do business with the company. SONEES stopped paying its bills, with the result that it was threatened with stoppage of electricity services, among others. "These financial difficulties have led us to juggle our creditors, and put them off as long as possible." The company cancelled all training programs, ignored scheduled maintenance procedures, and froze employment in an attempt to cut costs. The negative long term implications of these measures -- save perhaps the last -- is evident.

59. In accord with the provisions of the CP, SONEES approached the Ministry of Finance. Despite repeated resubmissions of their case, they received no reply of any sort during the whole of 1985. The simple fact was that "...despite the provisions of the contract-plan, no deposit has

been made to our account since 1 January 1985." The suggested solutions were obvious: government and the other public agencies must pay at once their bills; and steps must be taken to see that the arrears do not simply start again. SONEES officials suggested that at the start of each fiscal year the government should deposit in SONEES' account 65 percent of the previous year's budgeted payments. At the very least, pleaded the enterprise, government should pay its outstanding debts.

A Detailed Example: The SONATEL CP

60. Despite the difficulties with enforcing the provisions of the SONEES' and other CPs, "contractualization" was made a key feature of the government's "New Policy Towards the Parapublic Sector," announced in mid-1985. CPs were cited as one of the principal means by which enterprise performance would be improved. The policy stated that each year five enterprises would be submitted to the process. (The schedule has not been met.) Money-losing enterprises with a heavy social service obligation were to be given first priority. The policy implied that enterprises without a clear social service mission would be prime candidates for divestiture.

61. A positive example of the more recent crop of Senegalese CPs, showing how they have been modified in an attempt to deal with the prevailing high level of budgetary and economic uncertainty, can be found in the contract negotiated with SONATEL. The CP was signed in 1986, after close to two years of negotiations. (This enterprise is the telecommunications parastatal which was created after the break-up of the

OPT.) The standard features of a CP were retained: statement of enterprise objectives, commitments of the government, and mechanisms of monitoring the agreement. To these were added several other features: a detailed set of physical, financial and quality of service performance indicators, several means to pressure government in case of failure to honor obligations, and a section on how the plan could be modified, quickly, in case its financial and operational assumptions proved inaccurate. A review of the sections of this carefully prepared CP is revealing.

62. The preamble noted the high level of unsatisfied demand for telephone services in Senegal. It recalled government's decision to create a new, commercially-run and above all autonomous body to deal exclusively with this service (in line with the "New Policy..." the slogan of which was "manage less but manage better"). Section 1 (of seven) summarized the laws and decrees creating and regulating the company, emphasizing that the supervising ministries, technical and financial, "...carry out normally their roles, which consists of overseeing the strict application of the texts regulating the public service, but that they do not interfere, in either their advice or their actions, in the daily management of the enterprise." Section 2 offered the objectives of the CP exercise: to determine SONATEL's performance criteria; to determine the strategy and the actions the enterprise would take to attain its aims; and to define the obligations of the State to the firm. The third Section set out the firm's objectives in the contract period:

- to improve the quality of service;
- to complete on schedule several major investment and supply projects;
- to better utilize the firm's human resources;
- to determine a schedule for giving to every citizen "easy access to a telephone;" and
- to improve the image of the national telephone service.

### Performance Indicators

63. Section four dealt with performance criteria. The enterprise committed itself in the contract period to hold constant the number of employees, and to limit the annual rate of growth of its wage bill to 10 percent. The main measures of physical production were "number of requests filled for new principal telephone and telex lines;" and growth of the total number of telephones in use. Specific, quantified targets were fixed for each activity for each of the three years of the CP. The enterprise contracted to improve service quality, as measured by reducing the length of repair time, reducing the delay in obtaining a dial tone, and reducing the number of misdirected and incorrect calls due to faulty equipment or switching. Again, precise numerical measures of each of these indicators was stated in the CP (for example, repair of a telephone within eight days of request would rise from 66 percent of cases in 1985 to 80 percent at the end of the CP period).

64. SONATEL contracted to improve the productivity of its personnel. The measurement was that personnel costs, as a percentage of operating

revenues, would fall from 5 to 4.4 percent. With regard to the important issue of customer rates, the CP noted that a study on SONATEL'S tariffs was scheduled to be completed in January of 1988. In the interim, rates would be frozen at their 1985 levels, as long as the company maintained a minimum self-financing level of 40 percent. If the ratio fell below that figure, SONATEL could request an emergency rate hike.

65. Financial forecasts and performance indicators were equally detailed. Revenues, cash-flow, profits and operating co-efficients were projected for each year of the CP period. The same was done for investment matters; the contract estimated annual investment costs, and the amounts to be generated internally and raised externally to cover the investments. Total investments of 34.4 billion F CFA were forecast. SONATEL agreed to devote a small, precisely defined portion of its investments to creating telephone service in rural and remote localities; this was an "investment of a social character."

66. Considerable attention was paid to the issue of cost recovery. First, the company agreed to speed the issuance of bills to customers; the delay between meter reading and bill issuance was projected to fall from 51 days (1985) to 20 days in 1989. Second, SONATEL undertook to improve the position of its accounts receivable. The CP noted that as of 30.6.86 SONATEL was owed 12.3 billion F CFA in overdue subscriber accounts alone (of which 6 billion was owed by government and other parastatal agencies). The CP projected a complete cleaning up of the public overdue accounts by 1988, but only a modest diminution of outstanding private arrears. An annex laid out a precise schedule for the payment of public arrears.



Prominently displayed in the CP was the sentence: "It is assumed that the State will respect the payment timetable detailed in Annex 7." The same annex dealt with the repayment to the State, by SONATEL, of an outstanding loan of 4.4 billion F CFA, implying a net transfer of about 1 billion -- a large but not overwhelming sum.

67. Section five listed the commitments of the State towards SONATEL. The government agreed "not to impose on SONATEL investment charges for expanding service to remote localities" over and above those previously agreed to. It gave a commitment to pay, according to a set schedule, overdue accounts. Of course, most earlier CPs had had such provisions and, as noted, the government had failed to honor them. To counter this problem, article 23 of the SONATEL CP introduced a new idea. It read:

In order to avoid the recurrence of unpaid bills, the State commits itself to clearly set out in its budget, as well as in the budgets of the local governments and public enterprises it supervises, the sums necessary to settle the accounts and credits of SONATEL...

68. This linking of the CP directly to the budget process, not simply of the national government but of the local governments and public enterprises as well, had not previously been seen (though it had been called for in the SONEES review.) It is a simple and clever idea to which one cannot rationally object. No organization can put forward a reasonable excuse to ignore basic operating costs, of which telephone service is surely one. This commitment attacks the root financial problem of public enterprises in Africa, which is that governments have paid for their

services or met their financing obligations only when it is convenient for the public treasury, as opposed to when it is desirable or necessary, from the point of view of the firm.

69. The State agreed to abide by the recommendations of the tariff study. This was tantamount to agreeing to substantial increases, since a recommendation for increases was highly likely to be produced. It also contracted to treat seriously and sympathetically any price increase requested by SONATEL under the emergency provisions mentioned above. With regard to the enterprise's ambitious investment program, the government agreed "to take all measures to facilitate SONATEL's access to necessary external financing," within the limits of the public sector debt ceiling agreed with the IMF.

70. Section six was entitled "Monitoring of the Execution of the Contract-Plan." In what is now a standard Senegalese practice, and in sharp distinction to French procedure (where government monitoring of the CP is handled by the technical supervisory ministry), the CP created a Monitoring Committee for the supervision and change of SONATEL'S CP. This committee was composed of, on the one hand, the Director General of SONATEL and "his principal collaborators;" and for government, an eight person team consisting of the following officials "or their representatives:"

- the Director of the CP supervisory unit, Office of the President;
- SONATEL's Financial Controller (the representative in SONATEL of the Ministry of Finance, who is permanently attached to the PE);

the Director of the Bureau of Organization and Methods,  
Office of the President;

- the Director of the Budget Department, Ministry of Finance;
- the Director of the Debt and Investments Department, Ministry of Finance;
- the Director of Planning, Ministry of Plan;
- the Director of Finance Programming and Investment Monitoring, Ministry of Plan, and
- the Director of the Cabinet of the Ministry of Communications (all of the above are more or less permanent members of the committee; this official only attends the meetings dealing with the firms reporting to his ministry; he is replaced by his equivalent from other ministries when their PEs are concerned).

71. The CP states that this committee will meet at least twice a year; once in January to examine the firm's performance over the past year, and to review an annual report submitted by SONATEL's management; and in June to review progress and problems of the firm, vis-a-vis the provisions of the CP. The agreement states that if the firm is not attaining its objectives as contracted, or if the government is not honoring its commitments, the committee will examine the reasons for the problems and "will propose appropriate measures to remedy them," including, if necessary, thorough revision. Further:

If economic, social or financial conditions change to such an extent as to call into question the application of the present contract-plan, the committee will hold an emergency

meeting to determine the terms and timetable of the revised CP.

Finally, the committee bears the responsibility for reconciling disputes between the enterprise and government, but in case a matter cannot be resolved at committee level "the arbitration of the President of the Republic will be solicited."

72. The SONATEL contract contains a number of worthwhile innovations: very detailed performance criteria, including quality of service criteria; a minutely detailed timetable to resolve outstanding financial problems; direct linkage to the budget process; and a potentially powerful supervisory committee to oversee implementation and assist in the resolution of problems. Information obtained from SONATEL management and the supervising agency, the DRSP, in May of 1988, revealed that the firm was indeed achieving satisfactory performance on many of the indicators contained in the CP; specifically those referring to quality of service, productivity of personnel, internal financial projections and investment expenditures. However, problems were surfacing due to the fact that nothing at all had been done on the key issue of settling the State's arrears -- for which a precise timetable had been laid out in the CP. The State's failure to pay for services rendered was forcing SONATEL into a situation of extremely high indebtedness, as it resorted to bank overdrafts to cover its shortage of working capital. In sum, the CP provisions which are within the control of the enterprise are being met and are having a positive effect. But these are offset by the State's continuing failure to pay its bills.

A Senegalese Assessment of the CP Process

73. A government seminar on the CP process was held in December of 1986. Seminar participants, composed of government supervisors, enterprise managers and technical assistants working for both parties, discussed the CPs and their problems but nonetheless concluded that several benefits had been brought about by the use of the device. The final report of the seminar<sup>11</sup> concluded, without offering much in the way of supporting numbers or data, that CP'ed enterprises showed better personnel management, a superior capacity to estimate investment needs, more success in gaining approval for rate increases, and improved relations with suppliers of inputs -- resulting, in several cases, in lower prices. These are significant improvements, if they are widespread and not just isolated instances in an enterprise or two (the wording of the report makes it appear that the latter might be the case). Nonetheless, the bulk of the seminar was spent analyzing deficiencies of the process, and proposing remedies.

74. The seminar confirmed the obvious; financial relations, or more plainly put, the government's failure to pay, is the problem, though other issues are certainly important. For example, lip-service is paid to the concept of management autonomy, but, in practice, managerial latitude remains quite limited. Managers expressed concern over the quantity and quality of performance indicators, arguing that there should be a

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11/ See "Rapport de Synthese du Seminaire de decembre 1986 sur les Contrats-Plans," Cellule de Contrat-Plan, Dakar, 1986.

distinction between those which are formal commitments of the enterprise, and those which are merely projected desirable outcomes. The former should be as few and as clear as possible; in their opinion, the latter should be relegated to annexes and not figure in the body of the CP. Managers also wanted to see some linking of enterprise performance to sanctions and rewards, and thought this could be built into the CP process.

75. By far the most compelling topic was that of finances. Participants came up with many worthwhile suggestions on how to overcome the evident problems. First, they asked for involvement of Treasury officials (the Ministry of Finance officers responsible for actual payments) in the negotiations and monitoring of the CPs. Second, they requested that a formal payment timetable, agreed to by the Ministry of Finance, be included in each CP. Third, they asked that Finance at least inform PEs when late payments are in the offing. Fourth, they wanted a simplification of the absurdly complicated paperwork that the State requires to verify charges and payments. Fifth, a number of suggestions were made on linking PE payments to the budgeting cycle. Sixth, a call was made for two new committees, one specifically to follow the arrears issue, and the other to restructure financial matters as a whole. The most frequently repeated word in the entire report was "rapidly;" participants agreed that delay was strangling the Senegalese parapublic sector, or at least adding greatly to its costs of operations. The CP process was adopted precisely to help resolve these problems; and one could argue that the first step towards resolution -- quantifying the extent of the difficulties -- is being achieved.

76. Nonetheless, the State's failure to pay has become so widespread that SAL III (1987-88) made the settlement of State obligations, as set out in the existing CPs, a condition of second tranche release. Government only managed to meet the condition, at the very last moment, by unilaterally decreeing that the sums given in the CPs and lettres de mission were all revised downwards, thus allowing the State to claim that it had met the conditions. On the one hand, this was a welcome admission that the sums contained in the CPs were unrealistic, and that they must be reduced. On the other hand, the unilateral change of figures negates the basic principle of the CP process: open negotiation of "les engagements reciproques." The change, without any consultation in the affected firms, has added to managers' disappointment and cynicism concerning CPs. This action highlights yet again the non-contractual nature of CPs. because first, they can be changed by the dominant party without the involvement or knowledge of the subordinate party; and second, the dominant party cannot be sued or otherwise subjected to legal actions if the terms of the "contract" are not fulfilled.

77. Attitudes prevailing (in May of 1988) in Dakar concerning the CP process reflect these shortcomings. Most interviewed managers said that many aspects of the process were worthwhile, and cited the positive points referred to above. A few more openly said that little or nothing was coming of CPs, and the meager results were not worth the time and effort they had to devote to their creation and implementation. The DRSP's March, 1988, review of the sector's progress listed each of the CPs in force; in almost every case one finds a statement that:

- "only 50 million (F CFA) have been inscribed instead of the 550 million initially proposed;"
- "the State has still not put the promised 100 million at the disposition of the firm;"
- "the operating subsidy of 300 million has still not been executed;"
- "231 million should have been transferred; 186 million have been received;" etc.

78. To repeat, it is not only reasonable, it is necessary and essential that Senegal reduce the sums invested in its inefficient PE sector. But this should be done by drawing up reasonable and realistic CPs in the first place; not by creating elaborate and expensive wish-lists which have no chance of being implemented, and which -- when they are shown to be unworkable and have to be continuously revamped or are unilaterally revised downwards -- demotivate and discourage enterprise managers.

#### Conclusions on Senegal

79. Most of the problems discussed in this review of the CP process in Senegal have resulted from shortcomings of government, either shortcomings of policy or deficiencies in execution and implementation. This is not to imply that management has been without fault; that were it not for government's weaknesses the CPed enterprises would have all made dramatic gains in productivity and efficiency. The more complicated truth is that many Senegalese public enterprise managers are insufficiently well-trained and experienced. A portion of the blame for poor performance must be assigned to management, and to unskilled and indisciplined workers. The



point for this review, however, is that the light generated by the CP exercise shines mainly on government failures. For example, it is clear that one problem in Senegal has been the relative weakness of the officials heading the Contract Plan Supervisory Unit in the Office of the President (formerly the la Cellule de Contrat-Plan; changed in 1987 to become a more high-powered Delegation a la Reforme du Secteur Parapublic). To the present, this and other overworked and understaffed review bodies have failed to exert sufficient pressure on budget and disbursement offices to persuade them to make promised payments, on time and in the proper amounts. This is not to dispute the difficulty of their task. All the aggressive persuasion in the world will not work when the Treasury has no further resources to allocate. (Though this raises again the larger question of how could the government commit itself to a group of CPs, the aggregate funding provisions of which far exceeded the most optimistic estimates of resource availability?) But some of their problems seem self-inflicted. For example, the Unit did not even hold a meeting to discuss SONEES' disturbing December, 1985, report until June of the following year. Recent changes in the leadership and operating terms of reference for this important body will, it is hoped, lead to greater fulfillment of the stipulations of the CPs, in SONATEL and elsewhere. But leadership alone is not enough; there should be a reinforcement of this key agency.

80. The overall point is that it is not simply the technical quality of the CP's provisions which is important, but also the nature of the institutional setting designed to prepare and promote the exercise. In the absence of definitive evidence that the provisions of a CP, even one as carefully constructed as that of SONATEL, can overcome the difficulties

prevailing in Senegal, the interim conclusion must be the experience has not produced the desired results.

81. Review on the ground reveals a steady stream of delays, missed deadlines, disagreements and misunderstandings in the creation and implementation of CPs. One CP went through nine drafts over a two-year period before it could be signed. In another case, a manager stated that he had been instructed to sign his CP, even though he was not in agreement with its major provisions. He indicated informally that he had no intention of implementing its measures. A May, 1986, supervision report noted that the scheduled preparation of four statements of objectives and twelve CPs were all delayed, some indefinitely so. The problem appeared to be that as drafters dealt with the fundamental financial issues, similar to the SONATEL approach, government grew reluctant to commit; if these issues were ignored then managers refused to sign. Other cases were awaiting the results of studies, passage of legislation, coordination with the plans of other PEs, etc. Some of the fault for the slow pace of activity lay with the ineffective supervision unit, but it also seems reasonable to think that the negotiation/coordination workload was vast and overwhelming. Whatever the reason, the fact remained that none of the CPs scheduled for signature in 1986 was signed on time, and many remain unsigned and dormant to the present time. In those that were signed many key provisions have not been kept. Dramatic, short-run improvements in performance have not been brought about.

82. The primary lesson is clear: contract-plans cannot by themselves overcome the several, serious, deeply rooted problems of the Senegalese

parapublic sector in particular, much less the related but grander scale problems of the economy as a whole. The fundamental starting point is the country's sheer and intense poverty, the effects of which are compounded by weak budgeting systems (which translate into a lack of reliable information on either the availability or liquidity of funds), weak agencies of review in the technical and financial supervising ministries, and weak political commitment to the concept of financial discipline. The CP process highlights these deficiencies, and shows that not all problems are the fault of management; but it does not eliminate them. Moreover, the contract-plan is meant to be both binding and a plan. Yet, the Senegalese experience reveals the difficulty of binding the government, and the difficulty of constructing a plan that is both realistic and implementable. In miniature, the informational shortcomings of comprehensive planning are reproduced in the CP process.

83. The French have tried to solve the problems of complexity and uncertainty by moving away from comprehensive CPs towards shorter, more general statements of intent and broad policy. The idea is to maximize the benefits of mutual goal-setting and formalized dialogue, which the CP process provides, without becoming bogged down in specific numbers and quantities. But Senegal (as other African users of CPs) has generally been obliged to retain a greater degree both of specificity and complexity in its contracts. This has been unavoidable given the extent of market imperfections, distortions and government interference in the Senegalese economy, plus the acute financial weaknesses and poor performance of the firms subjected to the CP process, the rapid and unpredictable shifts in

international markets important to Senegal, and weak analytical/institutional frameworks.

84. In short, the Senegalese have so many problems to deal with that they cannot pare their CPs down to the bone. Thus, the first Senegalese reaction to uncertainty and difficulty in obtaining government commitment to the CP provisions has been to use shorter intervals -- often now every six months -- of review and modification, if necessary. A second move has been to strengthen the supervisory committees and agencies, to increase their capacity to understand what is happening at the level of the firm, and to approach directly financial authorities and to push them to honor obligations. The second initiative has not yet proven effective; the first has led some involved in the process to ask if a document subject to change twice a year can really be called either a contract or a plan.

85. Irrespective of the problems, the Bank's involvement with the CP process continues. The parapublic sector is an indispensable element of the structural adjustment operations the Bank has concluded with Senegal since 1984. Despite the deficiencies of what has so far been done, something along the lines of what the CP attempts must be installed if the sector is to be rationalized. Though complaints about the amounts of time and effort required to devise, negotiate and supervise a CP are common, it could still be argued that this is a relatively low cost tool which is setting the scene for reform. Nonetheless, it would appear that at present, levels of enthusiasm for the CP concept have declined. An October, 1987, review reiterates that the "major problem in the sector is the whole area of financial relations between the State and the public

enterprises," and notes that privatization and liquidation of PEs are now the more burning issues.

86. Theoretically, one way to improve the situation is by substantial down-scaling of the PE sector, which would, presumably, allow a higher concentration of scarce State capital and management resources on the priority group of strategic utilities and enterprises. In October of 1987 the government announced the first implementation phase of its privatization program; as of May of 1988 no sales had actually taken place. Most of the activity proposed will be devoted to reducing the percentage of government holdings in joint ventures; only two wholly-owned companies -- and certainly none of the large, monopoly, social-service providing money losers -- will be touched. One awaits the impact of this program.

87. In the end, despite all the problems associated with its implementation, one cannot dismiss the concept of the contract-plan. It is no panacea; by itself it will not and cannot overcome the effects of high levels of uncertainty in markets, or the mistakes, willful or otherwise, of government policy. However, in the longer run, and in conjunction with more rational and appropriate macroeconomic signals, it is quite possible that the CP's emphasis on clear goals and especially on increasing the transparency of operations could render important, low cost assistance in the search for more productive, efficient public enterprises. That is, the CP cannot substitute for government commitment to managing rationally its resources; if such a commitment is lacking then no technique can take its place. But it can provide, and is providing, rationalist reformers with the informational ammunition to structure and legitimate reform.

### Recommendations

88. The CP process is worth rescuing and continuing, but strong measures must be taken to provide greater autonomy for managers, and to push the government to take more seriously its financial obligations.

These are:

(i) in the immediate, short-run, the cost-reduction and cost-recovery measures already set forth in existing CPs must be enforced. For example, the present SENELEC CP clearly states that the enterprise has the right and the obligation to cut electricity service to any subscriber, including public sector subscribers, whose account is 90 days overdue. SENELEC officials said they tried in 1987 to enforce this measure but were directed to desist. SENELEC's CP monitoring committee, and the DRSP, should come into action at this point, calling the attention of highest officials to the State's commitments, and pushing for enforcement of the agreed-upon rules.

(ii) In the slightly longer-run, there must be a strengthening of the links between the resource allocation system and the CP process. The CPs presently in effect, and all those being negotiated, require that each ministerial budget contain specified resources to cover (at least a reasonable percentage) of the ministry's payments to enterprises. CPs also contain detailed payment schedules for the settlement of arrears. These items have generally been inscribed in budgets. Nonetheless, as noted above, the payments are often not made, or made only in part and with great delay. The key issue is to ensure that the aggregate financial demands of public enterprises made in CPs, and agreed to by government, are in line

with the aggregate resources available. For the moment, the only way to start to effect this reconciliation is by reductions in the levels of subsidies and other, indirect means of State financing, to the PEs.

(iii) But in the long run, the way to ensure progress is by making the CPs effective. The way in which this can be done is by ensuring that government negotiators of CPs possess, first, the knowledge of what level of financing can, realistically, be made available to the enterprise, in terms of arrears, overdue accounts settlement, and levels of investment financing. Second, central reviewers must be empowered to impose these realistic financing limits on the enterprise. This necessitates a strengthened capacity within government, most likely in the Ministry of Finance, to project the legitimate financial requirements of public enterprises. It will also require a much strengthened capacity to project total resource availability, and to rank technically priority areas for expenditure.

89. None of this will be easy to achieve; the listing of what needs to be done, to allow the CP process to accomplish the grand objective of helping to impose financial discipline on the State, reveals the magnitude of the problem. What is certain is that the benefits of the present CP process are outweighed by the costs of negotiating so-called contract, containing unrealistic financial commitments, which the State then violates with impunity. The CP process is worth rescuing, but it will take a major commitment to do so.

## B. Other Developing Countries

90. No other developing country, African or otherwise, has had an experience with CPs comparable to that of Senegal. But many have started down the contractualization path. Table 1 summarizes the CP situation in fourteen developing countries, eleven of them francophone, twelve of them in Sub-Saharan Africa. The table is not at all exhaustive. It is possible that some African CPs are being devised which have escaped the survey's attention. Nor does the table cover the countries in which an interest in or intention to use the CP has been expressed, but not yet acted upon; e.g., Madagascar, Gabon and C.A.R., among others. Further, the devices similar to the CP which are in use or in preparation in Latin America -- in Mexico, Argentina and Brazil -- are neither covered in the table nor reviewed in this paper. Table 2 provides some information on where the installation of the CP process is being supported by the World Bank. The remainder of this section will review, more briefly than was done in the case of Senegal, the information available on CP use in a sample of other developing countries.

[INSERT TABLES ON NEXT PAGES]

### Congo

91. The Republic of the Congo, in the early 1980s, independent of World Bank advice or assistance, produced "program contracts" for ten major public enterprises. The primary purpose of the contracts was to increase managements' autonomy. None ever proceeded to the implementation stage; indeed, none of the ten were ever signed. The problem appears to have been



TABLE 1

CONTRACT-PLANS IN DEVELOPING COUNTRIES

Country	Total No. of Contract-Plans	Of which: Abandoned	Completed	Signed and In Progress	In Preparation	Envisioned
Benin	7			2	3	2
Burundi	5				5	
Congo	18	10				8
Cote d'Ivoire	5	2		3		
Gambia	6			3	3	
Guinea	1					1
Kenya	1					1
Madagascar	1				1	
Mali	1					1
Morocco	8		1	1	6	
Niger	2			1		1
Nigeria	2					2
Senegal	30		3	9	10	8
Tunisia	6	1			3	2
TOTAL	93	13	4	19	31	26

TABLE 2

CONTRACT-PLANS IN BANK PROJECTS

Country	Total No. of CPs	Of Which: Industry a/	Transport	Utilities	Agric.	Other
Benin	5	4	1			
Burundi	5	1	2			2
Congo	8	4	1	2		1
Cote d'Ivoire	4	1	1	1		1
Gambia	3		1	1	1	
Madagascar	1			1		
Mali	1					1
Morocco	6	2	1	1	1	1
Niger	1			1		
Tunisia	3				3	
TOTAL	37	12	7	7	5	6

a/ Includes mining.

that the drafting of the agreements degenerated into an open political conflict, with the firms using their versions of the draft CPs to air complaints about government policy. The effort was soon officially abandoned. Under an internal -- i.e., non-World Bank supported -- "structural adjustment" program in 1985, the Congolese government announced a re-start to its CP program. Government stated that a new model program contract was being designed and would soon be applied to the electricity company, the post and telecommunications agency and three other important PEs. But no actual progress was made on this front prior to the devising, with World Bank assistance, of a Public Enterprise Sector Adjustment Project (still in preparation at time of writing). A major feature of the proposed project is the restructuring of the six most important PEs, and the installation of appropriately designed and negotiated CPs. In common with many other cases to be considered in this section, the Congo has plans and hopes for the future of CPs, but little concrete, empirical experience to analyze -- other than the significant finding that the two false starts on the CP process indicate that the device is more complex to design and implement than was once thought (a reconfirmation of the Senegalese and French experiences).

## Morocco

### Royal Air Maroc

92. In 1982, the Moroccans installed a three year CP in the state-owned airline, Royal Air Maroc (RAM). It expired in 1984, and despite pleas for renewal from the company and the Ministry of Transport, a second

CP has not been negotiated. The RAM CP defined the firm's objectives, and laid out the airline's required non-commercial operations. It determined the formula for the State's compensation to the airline for losses incurred from public service operations and price restraints. Annual targets were established for volume of sales, manpower productivity, equipment use rates, total productivity, the wage bill, and the company's investment and financing plans. A "contrôleur de gestion" (management supervisor), an official of the Ministry of Finance, was appointed to oversee the proper implementation of the CPs. This official was supposed to replace the traditional "contrôleur financier" (financial supervisor) who represents the Ministry of Finance in every Moroccan PE; in fact, the "contrôleur de gestion" post was simply added on to the existing system. Though both of these officials are drawn from the same pool of civil servants, the management supervisor is supposed to have a lighter, more ex ante review function; and the title was modified to reflect the change of approach. Finally, the CP established procedures for determining what is owed to RAM by the government and other PEs, and set payment schedules for clearing up these arrears.

93. Internal and external observers agree that some significant improvements have come about in RAM due to the CP. Management autonomy is said to have improved, government interference to have declined. A modest but significant start has been made on the long process of shifting away from a reliance on a priori controls to a less rigid system of a posteriori evaluation of performance. Positive results are claimed in RAM's "system of internal control and medium term planning...The relationship of dependence of RAM on the government has been replaced by a contractual

relationship based on cooperation, constructive dialogue, and clearer definition of responsibilities."<sup>12</sup>

94. But as in Senegal, the CP's physical and financial projections of firm performance proved inaccurate, and -- most important -- the government "has paid only a fraction of the contributions to which it was committed..." Once again, financial commitments were not respected. With overestimates of sales and revenues, and a large accounts receivable burden, RAM has been forced to survive on overdrafts, the interest costs of which weigh down the balance sheet. One of the benefits of the CP has been to quantify the extent to which RAM's losses are a function of its poor capital structure, which, in turn, is a function of government's failure to pay. Thus, it would seem that government is in good part to blame for RAM's problems. This is not to say that RAM's management is beyond reproach. But the RAM experience, in combination with similar instances from France and Senegal, suggests that the common government assertion that the key PE problem is poor management, is a self-serving oversimplification.

95. Other problems have been somewhat more technical: weak cost accounting, failure to revalue assets, productivity targets expressed in current as opposed to constant prices, and inability of the firm's financial officers to deal with exchange rate fluctuations. These are not problems of the CP per se; but their presence has severely weakened the

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<sup>12/</sup> See World Bank, "Kingdom of Morocco: Public Enterprise Sector Review," August 20, 1986, p. III, 23.

impact and utility of the process. CPs thus suffer from a problem common to many other reforms in LDCs: for them to have the anticipated beneficial impact, a complex host of other interrelated factors must be functioning to a modicum standard. If they are not, the impact is minimal.

96. The Moroccans have drawn several conclusions from this first application of the CP process. They see the desirability of making the CPs "rolling," i.e., subject to periodic review and modification. They recognize that the state must honor its obligations or the process will eventually founder. They see the need to link CP results with sanctions and rewards. They recognize that for CPs to work the contracted enterprise must have an adequate level of accounting, cost accounting and financial information systems. These lessons have been taken into account in the expansion of the CP process.

#### The Public Enterprise Restructuring Loan - The Moroccan PERL

97. An expanded operation, supported by the Bank, is presently underway. A Public Enterprise Restructuring Loan, the PERL, was negotiated in 1987 and became effective in December of that year. One of the main institutional development components of the PERL is the negotiation and signing of CPs in six important enterprises: the national electricity company, the national water company, the railway, two refining firms, and a holding company controlling private sector distributors of petroleum products. At the end of December of 1987, the CPs for the water authority and the holding company were signed and approved by government. Negotiations are underway for the remaining four CPs (in this first

experimental wave; the government will further expand the concept if the experience is promising). As a condition of the PERL, government is committed to having functioning CPs in all six enterprises by the end of 1988. While too early to judge definitively the effect on performance, there are elements in this attempt to spread the approach which merit mention.

98. First, the Moroccans are treating the exercise in an experimental and incremental manner. With the RAM experience in mind, neither the involved government staff nor the enterprise officials regard CPs as ultimate solutions for their evident problems, or as rigid and inflexible agreements. They are seen as first and necessary steps in a lengthy, adjustable reform process, during the course of which both sides will learn how to manage better the sector and the individual enterprises. This has led to the second point: Moroccan CPs have been entirely devised by government officers and enterprise staff. Consultant involvement, foreign or domestic, has been minimal. The reasoning appears to be that it is better to have imperfect documents, the preparation benefits of which accrue to Moroccan civil servants and enterprise managers, than technically perfect CPs, prepared -- and understood and supported -- only by outsiders.

99. The approach has some costs. Drafts produced by the dynamic but inexperienced contract-plan section of DEPP (the agency in the Ministry of Finance which oversees public enterprises and the reform program) tend to rely heavily on French examples and models. At least one draft CP produced directly by an enterprise, the railway (ONCF), was more of a statement of enterprise claims on the government than a balanced presentation of mutual

obligations and responsibilities. The draft was drawn up in September of 1985, and approved by the Ministry of Transport, the ONCF's technical supervisor. The Ministry of Finance then registered objections which have been the subject of prolonged, and unproductive, negotiations in the ensuing three years. A variety of taxation, depreciation, accounting and socio-political issues are involved; the point for this review is to reinforce the French conclusion that the more difficult the financial position of an enterprise, the greater the difficulty of installing a CP.

#### The Office National d'Electricite

100. The state of advancement of this most recent Moroccan CP process is illustrated by the experience of the national electricity company, ONE. Beginning in the mid-1987, bi-weekly meetings between ONE management and DEPP officials have produced several draft CPs. Government's timetable calls for signature of the contract in late 1988. Both enterprise and government officials describe current negotiations as animated. DEPP cadre acknowledge the quality of ONE's management, and the good quality of ONE's accounting and information systems. While negotiations are expected to be arduous, DEPP is confident that a high quality CP will be signed with ONE within the set time limit. ONE officials are somewhat more cautious, warning that government has a tendency to think that "the State has rights and the enterprise has duties." ONE would like to see more evidence of Ministry of Finance willingness to lighten financial control measures and accept the principle of compensating the enterprise for imposed social service obligations. That these issues are being openly debated is an encouraging sign.



101. The draft CP for ONE presently under discussion owes much, for its overall framework and even for some of its language, to the 1984-1988 CP of Electricite de France. As was the case with EDF, ONE's objectives and government's obligations are portrayed in general terms; the document does not have the detailed specificity characteristic of Senegalese CPs. For example, the company contracts to generate and distribute electricity at the lowest possible cost, to undertake an ambitious investment/construction program, and to work with "an optimal utilization of its human and capital resources." The State, for its part, promises to strengthen the autonomy of ONE's management, to clean up ONE's chaotic financial situation, and to provide ONE with "an economic, financial, legal and fiscal environment which favors the development of its activities."

102. The draft contract states that ONE will raise its self-financing level from 25 to 30 percent by 1991. This will necessarily entail rate increases; the State agrees to a 1988 study on ONE's rate structure. While awaiting the recommendations of this study, the State will allow a five percent rate increase in each of the next two years. For its part, the company, borrowing heavily from the wording in the EDF contract, proposed that any non-commercial activity imposed by the government would be costed out and compensation paid to the firm. DEPP negotiators rejected the proposed wording, and asked that the contract discuss specific instances of non-commercial operations rather than general principles. This is one of the matters presently under discussion. As presently written, the contract says that the State guarantees the loans entered into by ONE as part of its investment program, but specifies a debt ceiling which the firm cannot

surpass. Thirteen different physical and financial performance indicators are proposed. 13

103. At the end of the draft CP, ONE officials have inserted a seemingly innocuous paragraph on which they place great hopes. It reads:

With a view to safeguarding the interests of the State while preserving the autonomy of management of ONE, and while maintaining the dynamism necessary to a public establishment such as ONE, which is obliged to serve as a principle provider of economic and social development to the country, government authorities will take all necessary measures to substitute a posteriori controls for a priori measures.

ONE management views this statement of principle as a crucial first step in reducing the power, and perhaps eventually the presence, of the government-appointed accountant and financial controller. The reduction of their powers is regarded by public enterprise managers (not only those in ONE) as the most attractive feature of the CP. Government's reaction to this proposal remains to be seen.

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13/ These are: level of productivity of personnel, level of productivity of equipment, number of workers per installed KW in production, profit level of the grid, consumption of inputs, average level of value-added, rate of return on fixed assets, ratio of financial equilibrium, debt/equity ratio, debt service ratio, ratio of "tresorerie globale," ratio of the contribution of self-financing to investments, and the level of investment financing by external loans. The method of calculating all the indicators is given in an annex to the CP.

104. Overall, the Moroccan experience is quite promising. A long-term, "learning" perspective, has been adopted. There has been minimal reliance on external consultants (though there has been heavy borrowing from the French models), and maximum use of local personnel, in both government and the enterprises. Moroccan PE managers are sufficiently experienced and self-assured to recognize the potential benefits of CPs. In line with experience elsewhere, it is taking much longer than anticipated to negotiate the contracts; this suggests that there is a poor fit between rapid disbursement schedules of adjustment lending and institutional reforms such as CPs. The primary questions, as in Senegal, are whether the State accepts the basic, control-lightening philosophy underlying the CP process, and whether it will be able and willing to honor its financial commitments.

#### Other African Countries

105. Benin has implemented two instruments related to CPs, in the water/electricity public enterprise, and in the national brewery. No information is available on their impact on the firms' performance. Four other "action plans," which are not CPs, but rather imposed restructuring programs, are being prepared for five major money-losing public companies: two cement plants, a textile firm, the port authority and a shipping line. These agreements have been prepared at the insistence, and with the support, of the World Bank.

106. Burundi is presently preparing "performance contracts" in five key public enterprises: a pharmaceuticals company, a glass factory, a savings

association, a trucking company and an urban transport provider. The Ivory Coast is another country which, on its own, initiated a CP process in two public enterprises but abandoned them before implementation. Under its third Structural Adjustment agreement with the World Bank, the country has committed itself to extend the CP process to four major firms:

Palminindustrie, the national telecommunications agency, the port authority of Abidjan and the electricity company. As of late 1987, Palminindustrie was implementing -- apparently with considerable difficulty -- its signed contract; the process of negotiating the other three CPs was proceeding very slowly. Signatures were not expected before mid-1988, considerably later than anticipated.

107. Gambia is one of the first anglophone African countries to adopt the process. First, in late 1986 three "performance agreements" -- basically, restructuring plans to put the enterprises on a sound footing -- were drawn up for the peanut marketing enterprise, the water and electricity firm, and the port services company. The principal architects of the approach were external consultants, Coopers and Lybrand. Their services were paid for by a Bank loan. These agreements review, in the traditional form of a management consultant's diagnosis, the past performance, problems and prospects of the enterprises. Measures to improve performance are spelled out. The agreements were then followed by "performance contracts," which operationalize the suggested set of improvements, and set out an overall strategy for the firm. They also describe, in more or less standard CP form, the mutual obligations and responsibilities of the contracting parties.

108. The resulting documents are an interesting "anglo-saxon" variation on the CP theme. Particularly intriguing is the attempt to use the CP as a restructuring mechanism, at a time when most French analysts have concluded that the process of performance reform or improvement should be distinctly separated from the CP procedure. Another pragmatic innovation is the "pilot plan strategy," by which mini-versions of the full CP are signed and monitored closely for a three month period. Depending on the results during this trial run, the next performance contract would run for twelve months. Only if this experience proves positive will the more normal, pluriannual approach be adopted. At time of writing, two of the three firms have signed the trial run, three month agreements. External analysts had expressed concern that the original performance contracts were too detailed and complicated; this concern was shared by involved Bank staff. The result was that the contracts used in the trial runs have been slightly simplified. The experiment has just begun; there is no information on which to hazard even a tentative judgement as to their impact.

109. Madagascar, Mali, Niger and Togo have attempted to install CPs in at least one of their public enterprises. In Togo's case, efforts were made in 1982 to draft two CPs, one in an industrial firm, one in the national water company. Neither proceeded past first draft stage. The other three countries are presently negotiating CPs for one major firm (each). In these countries, as elsewhere in the region, CPs are most commonly applied to electricity producers and suppliers (in six different countries). As noted, a number of other Sub-Saharan countries are in the first stages of CP preparation.

First Efforts in India

110. Outside of Africa, India has long been seeking ways to improve the performance of its large and insufficiently profitable public enterprise sector. Interest in the contract approach was sparked by a January, 1986, seminar on the CP process -- presented in New Delhi by officials of the French government. The CP approach was generally outlined, and recommended for widespread application, in the report of the Sengupta Committee on Public Enterprise Reform, presented in December of 1986. In March of 1986, well before the release of the Sengupta Committee's document, a trial "memoranda of understanding" (the term the Indians use for CP) had been created and applied to the Oil and Natural Gas Corporation. This agreement ran for a one year period. In March of 1987 a second MOU was signed by officials of the corporation; it will run for two years. In September of 1987, a one year MOU was signed for the Steel Authority of India, Ltd. Negotiations are well advanced for MOUs in Bharat Heavy Electrical Ltd., and the National Textile Corporation. MOUs are also in preparation for two public holding companies in the engineering goods sector. If the results of MOUs are promising in these first instances, the process will be expanded.

111. An October, 1987, World Bank mission to review the Indian public enterprise sector included a specialist on CPs. His task was to assess the MOU process to date. The resulting report <sup>14</sup> noted the obvious: that it

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<sup>14/</sup> Thierry LeRoy, "Etude des Memoranda of Understanding," Banque Mondiale, Mission sur les entreprises publiques industrielles, decembre, 1987.

was too early to assess the process. However, a number of insights were generated. First, the MOU is seen within India as a way of achieving a much-needed increase in the autonomy of enterprise managers; indeed, this is its primary justification. Second, though modeled after the French CP process, the Indian conception contains some major differences. That is, MOUs in existence or in draft run for one or two years at most; they define the enterprise's physical and financial goals in great detail (but do not deal with investments); the sections on the state's obligations deal only with defining -- lightening -- the procedures of control and review and not with strategic issues or with matters of capital structure; and the autonomy so far granted to the enterprises is quite modest and circumscribed by government restraints.

112. Detailed reporting and monitoring systems are strictly applied by central authorities. Enterprises are required to submit extensive implementation reports each quarter. Officials complain that MOU monitoring procedures are added on to older reporting requirements; they are not substituted for them. Managers have not been able to obtain autonomy on several critical matters: pricing, schemes linking pay to productivity, and financial restructuring. The report argued that the MOU process had a long way to go in India, as government supervisors so far appear unwilling to shed their dirigiste attitudes and practices. The report viewed the first batch of MOUs as "incomplete," as not covering all the issues which need to be addressed. For example, none of the MOUs in force or in process deals with the non-commercial objectives or activities of the enterprise, and nothing is mentioned concerning compensation for these activities. The MOUs prepared to date are primarily statements of

enterprise objectives. The key commitments of the state, with regard to equity injections, subsidies, loan guarantees, pricing policy, investments and labor policy, are not spelled out. The report repeatedly underlines the admission that there are not yet sufficient data on which to base a measurement of the MOUs' effect on performance. Nevertheless, it concludes that the introduction of the MOU is a potentially progressive and beneficial idea. The major recommendation of the report is that the concept needs to be more thoroughly thought out, more fully applied.

### III. Conclusions and Recommendations

#### Summary of the Main Points

113. In 1967, the Nora Report recommended contractualization as a process to improve the productivity and efficiency of public enterprises. Twenty years later, French proponents of contract-plans stress their utility as devices which can:

...establish the "rules of the game" between the state and the enterprise...to define clear objectives and precise and limited mutual obligations...and above all to develop a climate of confidence between the representatives of the state and the managers of an enterprise.<sup>15</sup>

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<sup>15/</sup> This wording is used by Michel Testard, "Le Contrat-Plan," a presentation document of SEMA-METRA Conseil, Paris, decembre, 1987, paraphrasing an article by J. deChalendar, "L'Etat et les entreprises publiques dans les pays en developpement," Revue Francaise d'Administration Publique, octobre-decembre, 1984, pp. 595-610.



The view of what one can expect from CPs has thus evolved. First claims or hopes were quite ambitious; expectations have moderated, in the light of experience. This is natural. Reform mechanisms, no matter how well devised, supported and implemented, seldom achieve all the objectives put forward by their creators. Still, in France, CPs continue to be regarded as beneficial mechanisms by both their Gaullist inventors and their Socialist modifiers. Only liberals (well-represented in the Ministry of Economy, Finance and Privatization from 1986 to 1988), with their emphasis on scaling-down the state and enlarging the role of markets, have been less than enthusiastic. But even their views could change. The present pause in the French privatization campaign, brought about by the down-turn in world financial markets in the last part of 1987, and the re-election of the Socialists in 1988, will probably re-direct attention to the fundamental question of how to devise a mechanism which will optimize productivity, efficiency and the goals of the state. Moreover, governments do not have to concentrate on either privatization or performance improvement of PEs; they can and often do pursue both policies at the same time.

114. In both France and developing countries the individual CPs have been carefully crafted by skilled, experienced teams of civil servants and enterprise managers. In Senegal and several other African countries these national teams have been aided by consultants drawn from several of the better known European and North American firms. The point is that the technical competence of the CPs is not in question (with the exception of a few hastily prepared failures in Togo and Congo). The problems have been more in implementation and less in design. In France, this manifested

itself in the overly ambitious, excessively specific first group of CPs; but the process was, without too much difficulty, modified, simplified and rendered more general. In line with the shift in terminology, the process became less of a specific program and more of a sub-part of an overall plan. Along the way, the targets of CPs became broader.

115. For developing country users of the approach, the situation is different. In Sub-Saharan Africa one generally finds severe weaknesses in the core institutions of macroeconomic management -- i.e., the Ministry of Finance, the Budget department, the Treasury, the Planning offices. These central bodies responsible for the matching of the supply of government resources to aggregate demand often have failed to do their job. The result is that governments commit themselves to expend funds far in excess of what is available. As the Senegalese experience demonstrates, one result of governments being either unable or unwilling to honor their financial obligations is that the rationale for the CP process is called into question.

116. In Morocco, financial obligations of the state are being met under the PERL program. The crucial factors seem to be: (a) the existence of modest in scope and technically thorough CPs, combined with (b) a powerful and determined central body supervising the CP process -- in this case located in the Ministry of Finance -- which is willing and able to persuade, pressure and cajole Budget and Treasury authorities concerning the necessity of respecting resource and payment commitments and timetables. There is no guarantee that the honoring of commitments will continue indefinitely; that what has been accomplished in one or two

enterprises will automatically and smoothly be repeated in the growing number of enterprises submitted to the contract process (recall that the Moroccan schedule calls for signed CPs in six major enterprises by the end of 1988). Indeed, one could argue that the more enterprises with contracts, the greater the sums of money in question, and the greater the temptation for hard-pressed Treasury officials to resort to the old game of partial and/or late payments. (But other aspects of the Bank-sponsored PE reform program should alleviate this problem; e.g., tariff increases will raise the levels of self-financing of enterprises and reduce the need for state subventions.)

117. The Moroccan case suggests that the process requires a strong, well placed supervisory agency to assist in CP preparation, review implementation, and especially push for the proper fulfillment of the agreements. The difference between present progress and past difficulties (in RAM) seem attributable to the actions of the DEPP. Certainly the absence of a dynamic oversight body created difficulties in Senegal; a recent change of structure and personnel in the agency has resulted in some signs of progress. A difficult and delicate task for reformers is finding the proper balance between empowering the managers through the CPs, and at the same time endowing an oversight agency with sufficient "clout" to enforce the agreements.

118. The comparatively good state of development of Moroccan administrative agencies, and the basically sound management and procedures in the Moroccan public enterprises chosen to lead the reform program, meant that the CPs could be negotiated without recourse to external assistance.

The process is thus largely seen as an indigenous Moroccan endeavor, which may be a substantial benefit. One cannot read too much into the embryonic Moroccan program. The new CPs have just entered into operation, and there are some problem cases in the group to be negotiated in 1988. The verdict is hardly in; what one can say is "so far, so good."

119. Several countries have attempted to use the CP mechanism to restructure or resurrect desperately sick enterprises -- France in the case of the CGM, Senegal for the rural development agencies, all three undertakings in the Gambia, and two instances (not discussed in this review) in Bangladesh. Except for the Gambian case -- where, at first glance, performance seems to be improving markedly in PEs using CPs in this manner -- this usage has produced disappointing results. This would appear to lend weight to the conclusion that the CP is best used to regularize and improve the framework in which a firm operates; it is not automatically the mechanism of choice for healing a sick company. Results have been more encouraging when the CP is applied to enterprises with a modicum endowment of competent management, sound financial and reporting procedures, and a basically commercial orientation: Air France, SONATEL in Senegal, ONEP (the water company) in Morocco, Bharat Heavy Electricals Ltd. in India, for example.

120. The fact that the agreements have not, in spite of their name, proven to be legally enforceable contracts is particularly important. If governments cannot be legally bound to honor their commitments in the CP, then what is the status of the obligations imposed on the enterprise? The experience discussed above indicate that governments have often ignored,

with impunity, the covenants of their CPs. The negative operational results are evident. The question remains: what, if anything, can be done to increase the degree of legal enforceability of CPs, from the point of view of the enterprises (in most cases the government has sufficient powers at its disposal to impose its will on the companies). Shriill and persistent haranguing of resource dispensing authorities -- by a government oversight agency, an association of public enterprise managers or board chairmen, by interested staff of international assistance agencies -- has sometimes increased government's compliance with a CP's provisions. It does not solve the legal issue of whether a government will allow itself to be subjected to judicial proceedings to enforce a contract, especially where the complainant is a subsidiary body of the government itself. The unlikelihood of governments allowing themselves to be sued is a major reason why the term "contract" should be eliminated from the process. A more accurate term would be "performance agreement;" and indeed, the term is already in use in anglophone Africa and Latin America.

121. The way in which control structures have differed before and after the introduction of CPs is an insufficiently examined question. In Morocco and India, and probably elsewhere, the main attraction of CPs for enterprise managers has been the hope or the promise that the supervision process would be simplified and lightened; that some steps would be limited, that more latitude would be given to management, that the need for government approval on marginal matters would be eliminated. Yet in most instances, governments have proven reluctant to give up established control and review procedures. The provisions of CPs have been added to, and not replaced, traditional methods. To maximize the beneficial effect of the

CP, these instruments should replace -- not be added to -- existing supervision and control mechanisms.

Recommendations for Government and World Bank Staff

122. In light of this review, government planners and World Bank staff contemplating the introduction of a CP should exercise caution. The CP is of value, but its benefits have been oversold. Application of a CP can produce positive results, but it does not guarantee that performance will improve. The existence of a CP -- though signed in good faith by both parties -- will not, in and of itself, overcome the obstacles of poor policy, fiscal indiscipline and incompetent management. CPs must be part of a complex and concerted program of reform. Government officials and Bank staff should not expect that the application of a technique will change long standing attitudes and behavior patterns, especially when those patterns result in, and are reinforced by, material rewards.

123. The complexity of the PE reform process indicates that ambitions should be modest at the outset. CPs should be created for and applied in one or two test cases -- preferably social service providing monopolies -- on a trial basis. CPs should be clear, concise and as simple as the circumstances permit. Lengthy and minutely detailed specification of objectives and operating procedures is usually a sign that the process has been misinterpreted. The process of negotiation is as important as the document produced. Primary objectives for trial CPs might be limited to goal clarification, expansion of managerial autonomy, and the creation of a formal negotiating process. Expansion of the process to more complex goals

and larger numbers of PEs would come about when -- or if -- the device is shown to be of practical, measurable value. If this cautious approach is adopted, the implication is that the creation and implementation of CPs should probably not be matters for conditionality in Bank adjustment operations; at least until the process has been tested in-country and shown to be workable and beneficial.

124. Finally, the study raises a number of questions that cannot be resolved with available information. Further analysis should focus on: the revised role of the enterprise board of directors under a CP regime; more systematic assessment of CPs' performance impact; whether and how CPs change the way governments supervise PEs; and -- in the longer run -- comparison of countries using various forms of the CP mechanism, and comparison between countries using CPs and other types of performance evaluation devices; e.g., the systems in use in Pakistan and Korea.<sup>16</sup>

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<sup>16/</sup> For a brief description of the Pakistani "signaling system" used in industrial PEs, see Arntraud Hartmann and Syed Ali Nawab, "Evaluating Public Manufacturing Enterprises in Pakistan: An Experimental Monitoring System," Finance and Development, Vol. 22, No. 3 (September, 1985), pp. 27-30; and for Korea see Young C. Park, "A System for Evaluating the Performance of Government-Invested Enterprises in the Republic of Korea," World Bank Discussion Paper, No. 3, 1986.

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